

No. 83-1961-CFX  
Status: GRANTED

Title: Landreth Timber Company, Petitioner  
v.  
Ivan K. Landreth, et al.

Docketed:  
May 31, 1984

Court: United States Court of Appeals  
for the Ninth Circuit

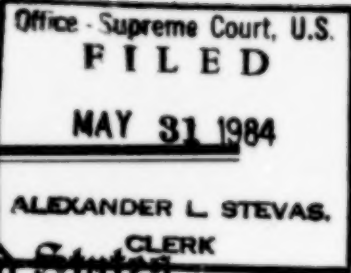
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Entry	Date	Note	Proceedings and Orders
1	May 31 1984	G	Petition for writ of certiorari filed.
2	May 31 1984	D	Motion of petitioner to expedite consideration of the petition for a writ of certiorari filed.
3	Jun 7 1984		Opposition of respondents to motion of petitioner to expedite consideration of the petition for a writ of filed.
4	Jun 8 1984		DISTRIIBUTED. June 14, 1984. (Above motion).
5	Jun 18 1984		Motion of petitioner to expedite consideration of the petition for a writ of DENIED.
6	Jul 2 1984		REDISTRIBUTED. September 24, 1984
7	Jul 5 1984	X	Brief of respondents Landreth, Ivan K., et al. in opposition filed.
9	Nov 5 1984		REDISTRIBUTED. November 9, 1984
10	Nov 13 1984		Petition GRANTED. The case is set for oral argument in tandem with No. 84-165, Gould v. Ruefenacht. *****
11	Dec 28 1984		Brief of petitioner Landreth Timber Co. (TO BE PRINTED) filed.
12	Dec 28 1984		Record filed.
13	Dec 28 1984		Brief amicus curiae of SEC filed.
14	Dec 28 1984		Record filed.
15	Jan 11 1985		Joint appendix filed.
16	Jan 11 1985		Brief of petitioner Landreth Timber Co. filed.
17	Jan 11 1985	D	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
18	Jan 21 1985		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument DENIED. Justice Powell OUT.
19	Feb 4 1985	G	Motion of Advance Ross Corporation for leave to file a brief as amicus curiae filed.
20	Feb 7 1985		Brief of respondents Landreth, Ivan K., et al. filed.
21	Feb 5 1985		SET FOR ARGUMENT. Tuesday, March 26, 1985. (2nd case).
22	Feb 11 1985		CIRCULATED.
23	Feb 25 1985		Motion of Advance Ross Corporation for leave to file a brief as amicus curiae GRANTED. Justice Powell OUT.
24	Mar 18 1985	X	Reply brief of petitioner Landreth Timber Co. filed.
25	Mar 26 1985		ARGUED.

83-1961

No. 83-



IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1983

LANDRETH TIMBER COMPANY,  
*Petitioner,*  
v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
AND KATHLEEN LANDRETH,  
*Respondents.*

**PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT**

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### **QUESTION PRESENTED**

Whether the purchase of all the common stock of a traditional business corporation is a transaction in "securities" within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934.

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LANDRETH TIMBER COMPANY,  
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*Respondents.*

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**PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT**

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Landreth Timber Company petitions that a writ of *certiorari* issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered on March 7, 1984.

**OPINIONS BELOW**

The original opinion of the United States Court of Appeals rendered on March 7, 1984, is not yet officially reported; it is unofficially reported at [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,705 (9th Cir. 1984). A copy of that opinion is attached as Appendix A. On April 24, 1984 one paragraph of that opinion was modified. A copy of the modifying order is attached as Appendix B. The unreported order and judgment of the United States District Court for the Western District of Washington is attached as Appendix C.



## JURISDICTION

The judgment of the United States Court of Appeals was entered on March 7, 1984. Jurisdiction to review that judgment by writ of *certiorari* exists pursuant to 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

The statutes principally involved in the opinion and order of the United States Court of Appeals and in this petition are the definitional sections of the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* The relevant portions of the definitional sections of those Acts, 15 U.S.C. §§ 77b(1) and 78c(a)(10), are reproduced in Appendix D.

## STATEMENT OF THE CASE

Prior to November 16, 1977, Ivan K. Landreth and his two sons<sup>1</sup> were the sole shareholders of Landreth Timber Company ("Landreth Timber"), which owned a sawmill in Tonasket, Washington. Ivan Landreth and his sons had earlier decided to sell their interests in Landreth Timber, but, before a buyer could be found, a portion of its sawmill burned. After the mill had been rebuilt partially, the Landreths succeeded in interesting a small group of investors in purchasing Landreth Timber.<sup>2</sup> The principal members of the investing group were Samuel S. Dennis, 3d, then a 67-year-old Boston attorney, and the late John Bolten, then an 84-year-old businessman who had retired in Florida. Neither Mr. Dennis nor Mr. Bolten had any experience in or knowledge of the lumber

<sup>1</sup> Mr. Landreth's wife and the wife of his son Ivan K. Landreth, Jr., were named as defendants because the proceeds of the sales by Messrs. Landreth inured to the benefit of the marital community composed of them and their wives.

<sup>2</sup> Although the Landreths now seek to avoid the application of the federal securities laws, they insisted from the outset that this transaction be structured as a sale of stock.

industry. Accordingly, their agreement to purchase the company was contingent on Ivan K. Landreth's agreement to assist in the company's management as a paid consultant.

A series of negotiations resulted in a detailed stock purchase agreement, with Mr. Dennis the purchaser, and Mr. Landreth and his sons the sellers, of Landreth Timber's common stock. Mr. Dennis' rights were assigned to a Delaware corporation, named B & D Company after Messrs. Bolten and Dennis, which had been formed for the sole purpose of acquiring Landreth Timber's common stock. After B & D Company became the owner of Landreth Timber's stock, it merged with Landreth Timber. The result of that merger was a Delaware corporation which bore the name of the original corporation, Landreth Timber Company.

Because neither Mr. Dennis nor Mr. Bolten were experienced in the lumber industry, their decision to purchase Landreth Timber's stock, and their valuation of it were necessarily, and importantly, influenced by their reliance upon information provided, and representations made, by Mr. Landreth. Mr. Landreth made representations concerning, for example, the cost of the mill's reconstruction, the ability to operate the existing machinery, and the productive capacity of the mill when fully rebuilt. Those representations were materially false. The actual cost of rebuilding the mill was substantially more than represented, and much of the machinery which Mr. Landreth represented and warranted to be operable was not. Even after the more expensive rebuilding process was completed and the inoperable machinery was replaced, the productive capacity of the mill was significantly below Mr. Landreth's representations. Accordingly, the mill could not be operated profitably. The mill was then sold, and Landreth Timber Company went into receivership.

Landreth Timber Company, the corporation which resulted from the merger of B & D Company and Landreth Timber, sued within one year of the stock transaction. Landreth Timber Company sought damages of \$2,500,000 for violations of the federal securities laws.<sup>3</sup> The defendants moved for summary judgment, basing their motion solely on the argument that, because the petitioner had purchased 100 percent of the stock of Landreth Timber, it had not purchased a "security."

The District Court granted the motion for summary judgment. Although the court found that the common stock purchased "possessed the ordinary characteristics of stock," it held that the common stock was not a "security" because 100 percent of the shares had been transferred. On appeal, the United States Court of Appeals for the Ninth Circuit affirmed. Recognizing that the issue "whether the sale of 100 percent of the stock of a closely-held corporation is a transaction involving a 'security' has divided courts and commentators," and was a question of first impression in the Ninth Circuit, App. A 5a-6a, the Court of Appeals held that the stock was not a "security." App. A 9a. The Court of Appeals concluded that earlier decisions in which it had adopted the so-called "risk capital" test to determine whether a note was a "security," required that it focus on the transaction rather than the instrument. App. A 8a-9a. Applying its analysis, the Court of Appeals held that the transaction was a "sale-of-business" rather than "a contribution of risk capital

<sup>3</sup> The common stock of the original Landreth Timber had been acquired for \$3,953,095. In its complaint, petitioner alleged violations of Sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77l(2) and 77q(a) and Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b). Landreth Timber Company also raised, as pendent claims, claims under the laws of the State of Washington. Those claims were dismissed for lack of jurisdiction upon the dismissal of the federal securities law claims to which they were appended.

subject to the entrepreneurial or managerial efforts of others," App. A 7a,<sup>4</sup> and held the federal securities laws inapplicable.

## REASONS FOR GRANTING THE WRIT

### **I. The Recent Grant of *Certiorari* in *Seagrave Corp. v. Vista Resources, Inc.* Requires That the Issue Presented By This Petition Be Determined By This Court.**

On May 14, 1984, *certiorari* was granted in *Seagrave Corp. v. Vista Resources, Inc.*, 696 F.2d 227 (2d Cir. 1982), *modified*, 710 F.2d 95 (1983) (*per curiam*) (terminating previously retained jurisdiction and remanding for trial), *cert. granted*, 52 U.S.L.W. 3185 (1984) (hereinafter "*Seagrave*"). *Seagrave* presents the identical issue of law presented here: whether the sale of all of the stock of a business corporation involves the sale of a "security" for the purposes of the federal securities laws. As more fully described in the next section, and as the Court of Appeals recognized in its opinion, that issue is one which has divided courts and commentators. Further, as reflected in the Solicitor General's *amicus curiae* brief in *Seagrave*, this issue is one which the Securities and Exchange Commission believes to have an important influence upon the federal securities laws.

In addition to the above interests, two additional reasons support the grant of this petition. First, unless the present petition is granted, petitioner will be denied the opportunity to have its rights determined on the basis of this court's ultimate decision in *Seagrave*. The *Seagrave* decision will establish a uniform rule for the Courts of Appeals, which are divided on the issue presented in this case. It would be unjust for the petitioner's case to be decided by any rule other than the rule to be declared by this Court.

<sup>4</sup> The Court of Appeals quoted from *Great Western Bank & Trust v. Kotz*, 532, F.2d 1252, 1257 (9th Cir. 1976) (citing *El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1229 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974)).



Second, the present petition offers the Court an opportunity to consider, in resolving this issue, a factual pattern distinct from *Seagrave*. In *Seagrave*, the purchasers were sophisticated businessmen acquiring the shares of a company publicly traded on the New York Stock Exchange. In contrast, the investors in Landreth Timber did not, as the Court of Appeals noted, have "any knowledge of the lumber industry." App. A 2a. Moreover, in contrast to the substantial information concerning publicly traded companies available in *Seagrave*, in appraising the value of Landreth Timber's common stock, the purchasers were required to rely upon representations made by Mr. Landreth, and upon any investigation the purchasers could conduct. Finally, because neither Mr. Dennis nor the late Mr. Bolten were of an age or background which made it practical for them to manage a lumber mill located a continent away, the factual context of their transaction provides a counterpoint to the acquisition in *Seagrave*, where the acquired company was to be folded into a company operated by the purchasers.

The petition for *certiorari* should, therefore, be granted. In addition to the importance of the issue to be resolved in *Seagrave*, the present petition should be granted to afford fair treatment to the petitioner by insuring that its rights are determined by the standard set by this Court's *Seagrave* decision, and to provide another factual context in which to consider the solution it proposes for this difficult issue<sup>5</sup> on which the circuits are divided.

## II. The Decision of the Ninth Circuit Court of Appeals Conflicts With Prior Decisions of Other Federal Courts of Appeals.

The Ninth Circuit's decision is squarely at odds with the rulings of three Courts of Appeals, and with the apparent conclusion of two others. In addition to the Ninth Circuit's recent resolution of the question, eight other

<sup>5</sup> Petitioner has filed at the same time as this petition a Motion for Expedited Consideration and Consolidation For Argument with *Seagrave*.

Courts of Appeals have addressed this issue. The Seventh,<sup>6</sup> Tenth,<sup>7</sup> and Eleventh<sup>8</sup> Circuits, like the Ninth Circuit, have adopted the "sale-of-business" doctrine. Three others, the Second,<sup>9</sup> Fourth,<sup>10</sup> and Fifth<sup>11</sup> Circuits have expressly rejected the doctrine, holding that so long as shares of stock possess the characteristics ordinarily associated with common stock, they are "securities." In addition, the Third<sup>12</sup> and Eighth<sup>13</sup> Circuits have, less directly, rejected the "sale-of-business" doctrine as an exclusion from the coverage of the federal securities laws.

This sharp division between the circuits creates an untenable situation in which questions of venue and personal jurisdiction dictate the availability of federal remedies. A purchaser who can obtain venue in either the Eighth or Ninth Circuit may find that the protection of the federal securities laws is obtained by filing in a District Court in the Eighth Circuit, but forfeited by filing

<sup>6</sup> *Sutter v. Groen*, 687 F.2d 197, 202 (7th Cir. 1982); *Canfield v. Rapp & Son, Inc.*, 654 F.2d 459, 465 (7th Cir. 1981); *Fredericksen v. Poloway*, 637 F.2d 1147, 1151-52 (7th Cir.), *cert. denied*, 451 U.S. 1017 (1981).

<sup>7</sup> *Christy v. Cambron*, 710 F.2d 669, 672 (10th Cir. 1983); *Chandler v. Kew, Inc.*, 691 F.2d 443, 444 (10th Cir. 1977).

<sup>8</sup> *King v. Winkler*, 673 F.2d 342, 345-46 (11th Cir. 1982).

<sup>9</sup> *Seagrave Corp. v. Vista Resources, Inc.*, 696 F.2d 227, 279 (2d Cir. 1982), *modified*, 710 F.2d 95 (1983) (*per curiam*) (terminating previously retained jurisdiction and remanding for trial), *cert. granted*, 52 U.S.L.W. 3185 (1984); *Golden v. Garafalo*, 678 F.2d 1139, 1144 (2d Cir. 1982).

<sup>10</sup> *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202, 1204 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979); *Occidental Life Insurance Co. v. Pat Ryan & Associates, Inc.*, 496 F.2d 1255, 1263 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974).

<sup>11</sup> *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983).

<sup>12</sup> *Glick v. Campagna*, 613 F.2d 31, 35 n.3 (3d Cir. 1979).

<sup>13</sup> *Cole v. PPG Industries, Inc.*, 680 F.2d 549, 555-56 (8th Cir. 1982).

in a District Court in the Ninth Circuit. That anomaly is heightened by the fact that, given the interstate nature of many securities transactions and the vagaries of the venue provisions, it is entirely plausible that one party to a single transaction may have remedies under the securities laws, while another does not. See Seldin, *When Stock is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 Bus. Law. 637, 650 (1982).

The potential for inconsistent results is but a portion of the possible mischief worked by the current uncertainty surrounding the "sale-of-business" doctrine. Some of the courts adopting the doctrine have added to the geographic uncertainty of its application by extending a presumption that the rule applies to acquisitions of less than 100 percent of a corporation's outstanding stock, so long as the purchaser acquires a controlling block of shares. See *Sutter v. Groen*, 687 F.2d 197, 203 (7th Cir. 1982). See also *Christy v. Cambron*, 710 F.2d 669, 672 n.1 (10th Cir. 1983); *King v. Winkler*, 673 F.2d 342, 346 (11th Cir. 1982). Thus, for example, a purchaser who acquires 26 percent of the stock of a corporation from one seller, and later acquires 25 percent of that stock from a second seller may find that his first purchase involved a "security," but his second did not.<sup>14</sup>

Indeed, the "sale-of-business" doctrine may allow events which are to occur after the transaction—such as the degree of management control exercised by the purchasers—to influence the availability of the protection of the federal securities laws. Dependence upon such factually laden inquiries precludes any uniformity or pre-

<sup>14</sup> Moreover, ownership of less than 51 percent of a corporation's stock may, in some circumstances permit "control." Accordingly, it is often difficult to know how much stock is enough to constitute control. See, e.g., *Essex Universal Corp. v. Yates*, 305 F.2d 572 (2d Cir. 1962).

dictability of application, with courts analyzing transactions on a case-by-case basis to ascertain whether the complaining party was an entrepreneur purchasing a business, or an investor "investing" in stock.

This Court's grant of *certiorari* in *Seagrave* will produce a decision which replaces the current, checkerboard pattern with a uniform rule applicable in all the Courts of Appeals. The petitioner should be governed by that rule and *certiorari* should be granted to permit it to participate in the appellate process which determines that rule.

### III. The Court of Appeals Erred In Applying the "Investment Contract" Test to This Stock Purchase.

In 1933, Congress defined "security" in "broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933). The definitional section of both the Securities Act of 1933, 15 U.S.C. § 77b(1), and the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10), as well as later enactments involving securities,<sup>15</sup> all include the term "stock" in the definition of a security.

The starting point for the construction of any statute is the words of the statute itself, *Greyhound Corp. v. Mt. Hood Stages, Inc.*, 437 U.S. 322, 330 (1978) (subsequent history omitted), and this Court has warned against statutory interpretation contrary to explicit statutory language. *United States v. Rutherford*, 442 U.S. 544, 551 (1979). Indeed, this Court long ago declared that "stock" is generally recognized to be a security because financial instruments "such as notes, bonds, and stocks, are pretty

<sup>15</sup> See Public Utilities Holding Company Act of 1935, 15 U.S.C. § 79 *et seq.* at § 79b(16); Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.* at § 80a-2(36); and Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.* at 80b-2(18).



much standardized and the name alone carries well settled meaning." *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943). Moreover, such "[i]nstruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description." *Id.* at 351.

However, the Ninth Circuit and other courts adopting the "sale-of-business" doctrine have departed from the plain words of the statute employed by Congress in defining a "security," electing to substitute their view of "economic reality"—a concept originally developed for the exclusive purpose of determining the contours of the ambiguous term "investment contract"—for the words of the statute. That departure from the plain meaning of the statute not only is unwarranted, but also frustrates private expectations and engenders unnecessary uncertainty in the application and administration of the federal securities laws.

Few would suggest that the label chosen for an instrument by its author concludes the inquiry into the applicability of the definitional sections of the federal securities laws. This Court acknowledged as much in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), rejecting the suggestion that transactions "evidenced by the sale of shares called 'stock'" were automatically covered by the provisions of the federal securities laws "simply because the statutory definition of a security includes the words 'any . . . stock.'" *Id.* at 848 (footnote omitted). In *Forman*, the instruments in question, "stock" in a cooperative apartment complex, bore no real relationship to the kind of instrument normally comprehended by the term "stock." Faced with such a situation, this Court's use of the *Howey* investment contract analysis to ascertain "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others," *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946), was a recognition that a name

could not transform an interest in a cooperative apartment into a security.

But the Ninth Circuit erred in its extension of the *Forman* approach to this case. *Forman* does not require going behind the name of an instrument in the absence of a showing that securities labelled "stock" are anything "other than what they appear to be." *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202, 1204 (4th Cir.), cert. denied, 444 U.S. 868 (1979). Although *Forman* rejected a "literal approach" to the definition of a security, this Court expressly denied that the name of an instrument is irrelevant to deciding whether it qualifies as a "security." Accordingly, *Forman* emphasized that:

There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

421 U.S. at 850-51.

While imprecise notions of "investment contract" and "economic reality" may be useful when attempting to categorize instruments which strain to meet the common understanding of the name given to them, the use of these tests is inappropriate when the instrument represents precisely that bundle of legal rights which, in ordinary usage, is signified by its name. Here, the shares of stock, unlike those in *Forman*, have all the significant characteristics typically associated with "stock," are easily recognized as "securities" in the capital market, and, apparently, are "securities" when less than all of them are sold. No persuasive reason exists to conclude that Congress intended to withdraw the protection of the federal securities laws from their purchaser or seller because they were purchased or sold in a single transaction.

**IV. Excluding Common Stock of a Business Corporation From the Definition of "Security" Under the "Sale-of-Business" Doctrine Is of Major Importance to the Administration of the Federal Securities Laws.**

The proper definition of "security" is, necessarily, fundamental to the federal securities laws. The exclusion from that definition of an entire category of common stock transactions is inconsistent with Congress' intent to provide a uniform code of conduct applicable to transactions in common stock and other securities. In addition, the reasoning behind the holding of these cases portends further uncertainty as to the definition of a "security." Contrary to this Court's instructions in *Forman*, the Ninth Circuit appears to have treated the name of a financial instrument as "wholly irrelevant," cf. *Forman*, 421 U.S. at 850, to its status as a "security."<sup>16</sup> Only by consigning the name and attributes of the instrument to irrelevancy could the Ninth Circuit hold that an instrument having all the attributes of the most frequently encountered "security"—common stock—is not a security. If this approach is accepted, any measure of certainty in the application of the securities laws will be lost.

Indeed, the present issue has been seen by some as affecting issues broader than the question of whether the sale of all of the stock of a business corporation is a transaction in securities. As Professor Louis Loss has suggested, the "sale-of-business" doctrine comes "dangerously close to the heresy of saying that the fraud provisions [of the federal securities laws] do not apply to private transactions." Loss, *Fundamentals of Securities Regulation* 212 (1983). Whatever arguments may be mustered in favor of this "heresy," its acceptance would overturn nearly four decades of precedent in which courts have presumed that Congress intended to prohibit fraud in private, as well as public, securities transactions. See,

<sup>16</sup> See text, *supra* p. 11, quoting *Forman*, 421 U.S. at 850-51.

e.g., *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971); *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa. 1974).

This Court's grant of *certiorari* in *Seagrave* suggests that the resolution of the important issues directly presented by this case is forthcoming. Accordingly, *certiorari* should be granted in this case to permit the petitioner to be governed by this Court's forthcoming decision, and to participate in the appellate process which will govern its rights.

**CONCLUSION**

For the reasons discussed above, a writ of *certiorari* should issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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Dated this 31st day of May, 1984.

# **APPENDICES**

**APPENDIX A**

**UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT**

**No. 81-3446**

**LANDRETH TIMBER COMPANY,**  
*Plaintiff-Appellant,*

**v.**

**IVAN K. LANDRETH and LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
and KATHLEEN LANDRETH, husband and wife,**  
*Defendants-Appellees.*

**Decided March 7, 1984**

**Appeal from the United States District Court for the  
Western District of Washington.**

**Before: BROWNING, Chief Judge, TUTTLE \* and  
FARRIS, Circuit Judges**

**BROWNING, Chief Judge:**

The issue raised in this appeal is whether sale of 100 percent of the stock of a closely-held corporation is a transaction involving a "security" within the meaning of the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa, and the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk. The district court held that it was not, relying upon the "sale of business" exemption from the Security Acts. We affirm.

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\* Honorable Elbert Parr Tuttle, Senior Judge, United States Court of Appeals for the Eleventh Circuit, sitting by designation.



## I.

Defendant Ivan Landreth and his two sons were the sole shareholders of Landreth Timber Co. (Landreth I) which owned a sawmill in Tonasket, Washington. Landreth decided to sell the mill. Before a buyer could be found, a portion of the mill was destroyed by fire. Landreth began to rebuild, adding modern equipment and design innovations to increase production. Before construction was completed, Samuel Dennis, a Boston attorney representing a small group of investors, expressed an interest in purchasing the mill.

Landreth insisted on a sale of the stock of Landreth I rather than a sale of its assets. Negotiations culminated in a detailed stock purchase agreement. The purchasers formed a Delaware corporation, the B & D Company, to make the purchase. B & D completed the purchase according to the terms of the agreement. B & D then merged with Landreth I to form Landreth Timber Co. II.

Landreth declined the purchaser's offer to manage the mill but signed a one-year consulting agreement with Landreth II, terminable at will on 30-days notice. The purchasers hired a full-time manager; Landreth's post-closing role was purely advisory.

Neither Dennis nor Bolten (Dennis's principal partner) or the other investors in the group had any knowledge of the lumber industry. Their decision to purchase the mill was allegedly based on representations by Landreth as to the cost of rebuilding the mill, and its productive capacity when rebuilt.

For a variety of reasons, Landreth II was unprofitable. Landreth underestimated the cost of rebuilding the mill. Much of the machinery Landreth had warranted as operable was not. Appellant completed the rebuilding and replaced the inoperable machinery, but the productive capacity of the completed mill was considerably below Lan-

dreth's predictions. Unable to operate the mill profitably, Landreth II sold the mill and went into receivership.

Landreth II brought suit in the Western District of Washington, claiming damages of \$2,500,000 for violations of the federal securities laws. The district court granted summary judgment for the Landreths on the ground that the Landreth stock was not a "security" within the meaning of the Acts.

"Stock" is among the instruments listed in the definition of "security" under the Acts,<sup>1</sup> and the district court

<sup>1</sup> Section 2 of the Securities Act of 1933 states: When used in this subchapter, unless the context otherwise requires—

(1) The term "security" means any note, *stock*, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1) (emphasis added).

Section 3(A)(3) of the 1933 Act exempts

Any note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 77c(3).

Section 3(a)(10) of the 1934 Act states:

(a) When used in this chapter, unless the context otherwise requires—

(10) The term "security" means any note, *stock*, treasury stock, bond, debenture, certificate of interest or participa-

acknowledged the Landreth stock had all the usual characteristics of stock. Nonetheless, the court held that under the test announced in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), Landreth stock was not a "security."

*Howey* held an instrument to be an "investment contract," and thus a "security," if "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301. Although *Howey* did not address a transaction involving stock, the district court held it was required by *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), to apply the *Howey* test "to all cases where the meaning of a 'security' is at issue." The district court held the Landreth stock was not a "security" under *Howey* because by buying 100% of the stock of Landreth I, B & D Company necessarily expected to operate the business and did not expect to obtain "profits from the managerial or entrepreneurial efforts of others."

tion in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a) (10) (emphasis added).

The definition under the two Acts has been held to be "virtually identical," *Tcherepnin v. Knight*, 389 U.S. 332, 335-36 (1967).

## II.

Whether sale of 100 percent of the stock of a closely-held corporation is a transaction involving a "security" has divided the circuits and commentators.<sup>2</sup> The Sev-

<sup>2</sup> Compare Seldin, *When Stock is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 Bus. Law. 637 (1982); Thompson, *The Shrinking Definition of a Security: Why Purchasing All of a Company's Stock is Not a Federal Securities Transaction*, 57 N.Y.U. L. Rev. 225 (1982); Note, *The Security Status of Stock Transfers Incident to the Purchase of a Business: The "Sale of Business" Controversy in the Aftermath of Golden v. Garafalo*, 47 Alb. L. Rev. (1983); Note, *Function Over Form: The Sale of Business Doctrine and the Definition of "Security"*, 63 B.U.L. Rev. 1129 (1983); Note, *The Sale of Business Doctrine: A Decade After Forman*, 49 Brooklyn L. Rev. 1325 (1983); Comment, *Acquisition of Businesses Through Purchase of Corporate Stock: An Argument for Exclusion from Federal Securities Regulation*, 8 Fla. St. U.L. Rev. 295 (1980); Note, *The Sale-of-Business Doctrine—Golden v. Garafalo*, 1983 B.Y.U. L. Rev. 201 (1983); Note, *The Second Circuit Rejects the Sale of Business Doctrine*, 57 Tul. L. Rev. 715 (1983) (all endorsing the sale of business doctrine) with Black, *Is Stock a Security? A Criticism of the Sale of Business Doctrine in Securities Fraud Litigation*, 15 U.C.D. L. Rev. 325 (1983); Hazen, *Taking Stock of Stock and the Sale of Closely Held Corporations: When is Stock Not a Security?*, 61 N.C.L. Rev. 393 (1983); Karjala, *Realigning Federal and State Roles in Securities Regulation through the Definition of a Security*, 1982 U. Ill. L. Rev. 413; Prentice & Roszkowski, *The Sale of Business Doctrine: Relief from Securities Regulation or a New Haven for Welshers?*, 44 Ohio St. L.J. 473 (1983); Rapp, *Federal Securities Laws Should Protect Some Purchases of All or Substantially All of a Corporation's Stock*, 32 Case W. Res. 595 (1982); Comment, *A Criticism of the Sale of Business Doctrine*, 71 Calif. L. Rev. 974 (1983); Note, *Repudiating the Sale-of-Business Doctrine*, 83 Colum. L. Rev. 1718 (1983); Note, 61 Wash. U.L.Q. 659 (1983) (repudiating the sale of business doctrine). See also Fitzgibbon, *What is a Security?—A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 Minn. L. Rev. 893 (1980); Note, *Recent Ninth Circuits Developments in Securities Law*, 13 Loy. L.A. L. Rev. 985 (1980); Comment, *Securities Regulation: Application of the Federal Securities Laws to the Sale of a Closely Held Corporation*, 22 Wasburn L.J. 406 (1983); Note, *Continuing Confusion in the*



enth,<sup>3</sup> Tenth,<sup>4</sup> and Eleventh<sup>5</sup> circuits recognize the "sale of business" doctrine, under which a purchaser of stock who assumes control of a company is not an "investor" expecting profits from the efforts of others under the *Howey* test, and the stock purchased therefore is not a "security" within the meaning of the Acts. The Second,<sup>6</sup> Third,<sup>7</sup> Fourth,<sup>8</sup> Fifth,<sup>9</sup> and Eighth<sup>10</sup> Circuits reject the doctrine, and hold that the federal securities laws apply if the transferred instruments possess the characteristics commonly associated with stock.

#### A.

Although the precise question is one of first impression in this circuit, appellees argue that we have decided it in

*Definition of a Security: The Sale of a Business Doctrine, Discretionary Trading Accounts, and Oil, Gas, and Mineral Interests*, 40 Wash. & Lee L. Rev. 1225, 1280 (1983).

<sup>3</sup> *Sutter v. Groen*, 687 F.2d 197, 202 (7th Cir. 1982); *Canfield v. Rapp & Son, Inc.*, 654 F.2d 459, 465 (7th Cir. 1981); *Frederiksen v. Poloway*, 637 F.2d 1147, 1151-52 (7th Cir. 1981).

<sup>4</sup> *Christy v. Cambron*, 710 F.2d 669, 672 (10th Cir. 1983); *Chandler v. Kew, Inc.*, 691 F.2d 443, 444 (10th Cir. 1977).

<sup>5</sup> *King v. Winkler*, 673 F.2d 342, 345 (11th Cir. 1982). See also *Kaye v. Pawnee Const. Co.*, 680 F.2d 1360, 1366 n.2 (11th Cir. 1982).

<sup>6</sup> *Golden v. Garafalo*, 678 F.2d 1139, 1144 (2d Cir. 1982); *Seagrave Corp. v. Vista Resources, Inc.*, 696 F.2d 227, 229 (2d Cir. 1982).

<sup>7</sup> *Glick v. Campagna*, 613 F.2d 31, 35 n.3 (3d Cir. 1979) (court not persuaded Congress intended Acts to apply to small close corporations, but "a literal reading of the statute and governing precedent" indicate the Acts apply).

<sup>8</sup> *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202, 1204 (4th Cir. 1979); *Occidental Life Ins. Co. v. Pat Ryan & Assocs., Inc.*, 496 F.2d 1255, 1261 (4th Cir. 1974).

<sup>9</sup> *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983).

<sup>10</sup> *Cole v. PPG Indus.*, 680 F.2d 549, 555-56 (8th Cir. 1982) (interpreting Arkansas law).

substance in cases dealing with "notes," which, like stock, are instruments well-known in commerce and specifically listed in the statutory definition of a "security."

We have applied a "risk capital" test to determine whether in a particular transaction a note is a "security" under the Acts.<sup>11</sup> Under this test, a note is a "security" if it reflects "a contribution of risk capital subject to the entrepreneurial or managerial efforts of others." *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1257 (9th Cir. 1976), quoting *El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1229 (9th Cir. 1974). The test distinguishes investment transactions, which are covered by the Act, see *United States v. Carman*, 577 F.2d 556, 563 n. 9 (9th Cir. 1978), from routine commercial transactions, which are not, see e.g., *Great Western Bank*, 532 F.2d at 1257.

The sale-of-business doctrine rests upon the premise that the Acts apply only to investment transactions, and not to commercial or entrepreneurial transactions. See e.g., *Sutter v. Groen*, 687 F.2d at 201. The doctrine derives from *Forman*, in which the Court stated:

The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors.

421 U.S. at 849. The court added "Congress intended the application of these statutes to turn on the economic

<sup>11</sup> See *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426 (9th Cir. 1978) ("promissory note" and other instruments); *United California Bank v. THC Financial Corp.*, 557 F.2d 1351 (9th Cir. 1977) ("put" letter and accompanying notes); *Great W. Bank & Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976) (unsecured "demand note"); *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224 (9th Cir. 1974).

realities underlying a transaction, and not on the name appended thereto." *Id.* The doctrine looks to the *Howey* test to determine whether in "economic reality" the transaction involves an investment. Under *Howey*, as the district court noted, the test is whether "the scheme involves an instrument of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301.

The application of the *Howey* test to the acquisition of a business through purchase of stock is straightforward: when a person purchases control of a business, he does not make an investment from which he expects profits solely from the efforts of others. Although the transaction involves stock, the economic realities reflect acquisition of a business, not passive investment, and the Acts therefore do not apply. Cases that reject the sale-of-business doctrine look only to the nature of the instruments involved: if they possess the ordinary characteristics of stock, they are "securities" and within the coverage of the Acts without regard to the nature of the underlying transaction.

In contrast, both the sale-of-business doctrine and the risk capital test follow *Forman* and reject a literal reading of the statute in favor of an inquiry into the economic realities of the underlying transaction. Both include a transaction only if it involves "an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301. Both exclude essentially "commercial" transactions in which there is no "investment." Thus, risk capital cases and cases endorsing the sale-of-business doctrine interpret the Acts in precisely the same way.

We see no principled way to justify an analysis in which we determine whether a note is a "security" within the meaning of the Acts by examining the transaction in light of the statutory purpose, but determine whether

stock is a "security" by examining only the instrument and not the transaction in light of the statutory purpose. We therefore conclude that adherence to the principle of construction adopted in our "note" cases requires adherence to the "sale-of-business" exclusion from the Securities Acts of the purchase of 100% of the stock of closely-held corporation.

## B.

The sale-of-business doctrine is still evolving, and its contours remain in some respects uncertain. However, under any formulation of the doctrine, the economic realities of this transaction leave no doubt that the district court reached the correct result, at least with respect to the sole appellant in this case, Landreth II.

As to Landreth II, the underlying transaction involved the sale of an entire business, effected through a sale of 100% of the corporation's stock. Following the transaction, Landreth II had full control of the corporation, including the day-to-day operations of the mill and its employees. In "economic reality," the underlying transaction was a sale of a lumber business and, under the sale-of-business doctrine, was not an investment in a "security."

Appellant suggests summary judgment was inappropriate because there were disputed issues of fact with regard to Landreth's post-closing managerial role. Appellant asserts it purchased the Landreth stock only because it believed Landreth would supervise the enterprise without participation by members of the purchasing group until the mill was completed and profitable operations were underway. The uncontested facts belie this assertion. Purchasers attempted to convince Landreth to continue as manager of the mill, but he refused. Appellant employed its own manager who assumed effective control of the business. Landreth agreed to serve only as a consultant, and for no more than one year; even these services



were terminable at the will of appellant. Neither Landreth nor appellant's manager can be regarded as a third-party upon whose efforts the purchaser relied for its profit within the meaning of *Howey. Bitter v. Hoby's International, Inc.*, 498 F.2d 183, 186 (9th Cir. 1974).

### III.

While this appeal was pending Landreth II moved to add as plaintiffs Dennis, and Bolten individually and as the administrator of the estate of his wife, Katharine S.A. Bolten. Although appellant brought this motion under Fed. R. Civ. P. 19 to add parties plaintiff, in substance it is a motion to intervene under Fed. R. Civ. P. 24 since the parties to be added are appellant's controlling stockholders. A court of appeals may permit intervention where none was sought in the district court "only in an exceptional case for imperative reasons," *McKenna v. Pan American Petroleum Corp.*, 303 F.2d 778, 779 (5th Cir. 1962). Intervention is sought without stating any reason for failure to intervene in the district court beyond the fact that intervention would permit the additional parties to avail themselves of the doctrine recognized in *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982), decided after this appeal was filed. Bolten and Dennis were obviously aware of defendants' reliance on the sale-of-business doctrine in the district court. No "imperative reason" has been advanced to allow intervention at this late date. As appellees point out, intervention would raise new issues of fact and law not before the district court. See *Spangler v. Pasadena City Board of Education*, 552 F.2d 1326, 1328 (9th Cir. 1977). The motion is denied.

The judgment is affirmed.

## APPENDIX B

### UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 81-3446

LANDRETH TIMBER COMPANY,  
*Plaintiff-Appellant,*  
v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife;  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR., and KATHLEEN LANDRETH, husband and wife,  
*Defendants-Appellees.*

### ORDER

Before: BROWNING, Chief Judge, TUTTLE \* and FARRIS, Circuit Judges

The opinion dated March 7, 1984 is modified to delete the entire paragraph beginning: "For a variety of reasons, Landreth II . . .," slip op. at 1311. The following shall be added to the beginning of the following paragraph:

Landreth II was unprofitable. It sold the mill, and went into receivership.

\* Honorable Elbert Parr Tuttle, Senior Judge, United States Court of Appeals for the Eleventh Circuit, sitting by designation.

## APPENDIX C

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

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No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
and KATHLEEN LANDRETH, husband and wife,  
*Defendants.*

IVAN K. LANDRETH AND LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR.  
and KATHLEEN LANDRETH, husband and wife,  
*Counterclaim Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim Defendant.*

---

ORDER GRANTING SUMMARY JUDGMENT

THIS MATTER comes before the Court on cross-motions for summary judgment. Oral argument was heard on February 27, 1981. At the conclusion of that hearing, the Court indicated its inclination to grant summary judgment in favor of the defendants and asked counsel to submit a list of admitted facts bearing on the issue of

managerial control. Subsequent to the hearing, counsel submitted admitted facts and supplemental memoranda regarding managerial control. Counsel for the plaintiff also filed a motion for reconsideration. On April 17, 1981, the Court heard argument on the issue of managerial control. Having considered the motions, memoranda, affidavits, admitted facts, and being fully advised, the Court now finds and rules as follows:

This is an action by the plaintiff Landreth Timber Company to recover for violations of the federal securities laws,<sup>1</sup> state securities laws and state common law. The issue presented is whether the sale of 100% of the stock of a closely-held corporation is a transaction covered by the federal securities laws. This Court joins a growing majority in holding that the federal securities laws do not apply.

Summary judgment is proper where there is no genuine issue of material fact or where viewing the evidence and the inferences which may be drawn therefrom in the light most favorable to the adverse party, the movant is clearly entitled to prevail as a matter of law. *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1254 (9th Cir. 1976); *Marx v. Computer Services Corp.*, 507 F.2d 485, 487 (9th Cir. 1974). A factual issue is immaterial if resolution of the issue is not necessary in order for the court to reach its decision. *Cordas v. Speciality Restaurants, Inc.*, 470 F. Supp. 780 (D. Ore. 1979).

The material facts in this case are undisputed. The defendants sold 100% of the stock of the Landreth Timber Company to the plaintiff's predecessor-in-interest. The stock possessed the ordinary characteristics of stock.

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<sup>1</sup> Section 12(1), 12(2), and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 771(1), 771(2) and 77q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5 of the Securities Exchange Commission, 17 CFR § 250.10b-5.



The two principal financial backers behind the purchase, Samuel S. Dennis and John Bolten Sr., were not knowledgeable in any aspect of the lumber industry.

Prior to closing the transaction, the purchasers retained Phil Cook to be general manager of the mill after closing. On the closing date, November 17, 1977, two agreements were entered into: (1) a stock purchase agreement which transferred 100% of the stock and required the defendants to deliver to the purchasers the signed resignations of all the officers and directors of the Landreth Timber Company, and (2) a consulting agreement between Ivan K. Landreth Sr. and the purchasers. The nature and scope of Landreth's post-closing role as consultant was defined in the consulting agreement as follows:

1.2 *Consulting Duties, Etc.* The Company shall employ the consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as a consultant to the Company in connection with such participation and for such purposes.

Pursuant to this agreement, Landreth's role was purely advisory; the authority to make any and all managerial decisions was transferred to Phil Cook and, ultimately, to the purchasers. The consulting agreement also provided that Landreth's post-closing employment was terminable by plaintiff at will upon thirty days' prior written notice.

Subsequent to closing the transaction, it allegedly became apparent that numerous misrepresentations had been made by the defendants during the course of nego-

tiations. The plaintiff terminated the consulting agreement with Landreth and filed this action.

The threshold issue in this case is whether the stock involved is a "security." The parties agree that a transaction evidenced by the sale of stock is not necessarily a security transaction simply because the statutory definition of a security includes the words "any . . . stock." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 848 (1974). Rather, the courts adhere to the principle that "in searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

What, then, are the relevant "economic realities" that must be examined? How closely should a court examine a stock before determining whether it is a "security"? It is here that the parties differ. The plaintiff contends that the Court should constrain itself to examining the characteristics of the stock itself. The plaintiff points out that Landreth stockholders have the following rights: receiving notice of any shareholders' meeting; electing and removing directors and filling vacancies; receiving certificates representing their ownership interest; transferring shares to a third party; receiving declared dividends; amending by-laws; and all rights granted to shareholders by Washington law. The plaintiff argues that these traditional characteristics of stock would lead a reasonable purchaser to assume that the securities laws would apply and, therefore, the Court should look no further.

The defendants, on the other hand, urge the Court to look beyond the characteristics of stock to the economic realities of the underlying transaction. They contend that the transaction at issue was essentially the sale of a business, through the transfer of stock, and that such a transaction is not within the purview of the federal securities laws.

This issue can be resolved only after a careful reading of the Supreme Court's decision in *Forman, supra*. In *Forman*, residents of a cooperative housing project, who had been required to purchase "stock" in the housing cooperative in order to acquire a residential unit, filed an action for fraud under the federal securities laws. The Court held that the shares of stock did not constitute "securities" within the meaning of those laws.

In part "A" of the *Forman* opinion, the Court rejected the argument that a transaction, evidenced by the sale of shares called "stock," must be considered a security transaction simply because the statutory definition of a security includes the words "any . . . stock." 421 U.S. at 848. In doing so, the Court emphasized the purposes underlying the federal securities laws.

The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. 421 U.S. at 849.

The Court concluded that the "stock" before it was not a "security" within the meaning of the federal securities laws. In doing so, the Court relied both on the fact that the shares did not possess the characteristics traditionally associated with stock (e.g. no dividends, no right to pledge or hypothecate, no voting rights), and on the fact that the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit. 421 U.S. at 851.

In part "B" of the opinion, the Court rejected the Court of Appeals' conclusion that a share in the housing

cooperative was an "investment contract" as defined by the Securities Acts, and rejected the plaintiffs' further argument that in any event what they agreed to purchase is "commonly known as a 'security'" within the meaning of those laws. The Court stated:

In considering these claims we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a 'security'." In either case, the basic test for distinguishing the transaction from other commercial dealings is

"whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301.

This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. 421 U.S. at 852.

Three aspects of the above-quoted passage should be noted in particular. First, the Court states that "we again must examine the substance—the economic realities of the transaction. . . ." (emphasis added). This is a further indication that the Court in part "A" was looking to the economic realities of the underlying transaction, and not simply examining the characteristics of the stock instruments themselves. Second, the Court indicates a distinction between security transactions and "other commercial dealings." As the Court states later in the same paragraph, in a securities transaction the investor is attracted solely by the prospect of a return on his investment. 421 U.S. at 852.



By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or develop it themselves" as the *Howey* Court put it, *ibid.*—the securities laws do not apply. 421 U.S. at 852-53.

Finally, it should be noted that the Court states that the *Howey* test "embodies the essential attributes that run through all of the Court's decisions defining a security." (emphasis added). This is a strong indication that the Court intends that the *Howey* test be generally applicable to all cases where the meaning of "security" is at issue, not just cases involving the definition of "investment contract." This conclusion is further supported later in the *Forman* opinion where the Court states:

What distinguishes a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others. . . . 421 U.S. at 858.

For these reasons, this Court concludes: (1) that it must look beyond the characteristics of the stock itself to the economic realities of the underlying transaction, (2) that it must bear in mind a distinction between security transactions and other commercial dealings, and (3) that the *Howey* test focuses on the relevant "economic realities" and is applicable in determining whether a stock transaction is within the purview of the federal securities laws. These conclusions comport with the majority of post-*Forman* decisions. *Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir. 1981); *Chandler v. Kew*, Fed. Sec. L. Rptr. ¶ 96,966 (10th Cir. 1977); *Bula v. Mansfield*, Fed. Sec. L. Rptr. ¶ 96,964 (D. Col. 1977); *Dueker v. Turner*, Fed. Sec. L. Rptr. ¶ 97,535 (D. Geo. 1979); *Anchor-Darling Industries v. Leonard Suozzo*, No. 79-4085, E.D. Penn, March 16, 1981; *Barsy v. Verin*, No. 79 C 3323, N.D. Ill., February 25, 1981. But see *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir. 1979); *Titsch Printing, Inc. v. Hastings*, 456 F. Supp. 445 (D. Col.

1978); *Bronstein v. Bronstein*, 407 F. Supp. 925 (E.D. Penn 1976).

In applying the *Howey* test, this Court need only determine whether the third requirement has been met, whether the purchasers were led to expect profits from the managerial or entrepreneurial efforts of others. This determination must be made based on the factual circumstances at the time of the agreement and not on facts occurring subsequent to the agreement. *El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1228 (9th Cir. 1974). It also irrelevant for the purchasers to argue that they relied on Landreth's past efforts to build up the business. As the Seventh Circuit stated in *Emisco Industries v. Pro's Inc.*, 543 F.2d 38 (7th Cir. 1976):

This only repeats plaintiffs' allegation of reliance upon misrepresentations made during the purchase. The important element for the transaction to constitute an investment is that [the purchaser] relied on the present and future efforts of another to produce profits. 543 F.2d at 41.

Thus, events occurring prior to the agreement are relevant only insofar as they indicate whether the purchasers, as of the date of the agreement, were led to expect profits resulting from the future entrepreneurial or managerial efforts of others.

The purchasers argue that the third requirement of *Howey* has been met because they were led to expect profits from the efforts of Landreth and Cook. In other words, the purchasers argue that Landreth and Cook are "others" for purposes of the third requirements of the *Howey* test.

This argument exalts a literal reading of the *Howey* test over the purposes of the federal securities laws. The fundamental purpose of those laws is to protect those who place their money in the hands of someone over whom they exercise little or no control. Persons or entities who are beyond the control of the purchaser are

"others" within the meaning of *Howey* and *Forman*. Employees, including managers and consultants, are not. *Bitter v. Hoby's International Inc.*, 498 F.2d 183 (9th Cir. 1974). In the words of the Ninth Circuit in *Bitter*:

For the manager to be a "third party," within the meaning of the *Howey* test, the manager must be outside of the direct and immediate control of the franchise. 498 F.2d at 186.

In the present case, both Landreth and Cook, as employees, were under the direct and immediate control of the purchasers after the sale and, therefore, they are not "others" or "third parties" within the meaning of *Howey* and *Forman*. Because there are no "others" involved in this case, it is not necessary to apply the analysis in *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973).<sup>3</sup>

For these reasons, the motion for reconsideration is DENIED and the defendants' motion for summary judgment is GRANTED.

IT IS SO ORDERED.

The Clerk of this Court is directed to send uncertified copies of this Order to all counsel of record.

DATED at Seattle, Washington, this 29th day of April, 1981.

/s/ Barbara J. Rothstein  
United States District Judge

<sup>3</sup> In *Turner*, the promoter/seller was beyond the control of the purchasers and, therefore, it was an "other" or "third party" within the meaning of *Howey*. This made it necessary to analyze whether the undeniably significant efforts were those of the purchasers or those of the promoter. But, in the present case, Landreth and Cook are not "others" because they were within the control of the purchasers and, therefore, there is no occasion to analyze whether the undeniably significant decisions were made by Landreth, Cook, or the purchasers.

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
Plaintiff,

v.

IVAN K. LANDRETH, et al.,  
Defendants.

JUDGMENT

This matter having come on for consideration before the Court, Honorable Barbara J. Rothstein, presiding, and the issues having been duly considered and a decision having been duly rendered,

IT IS HEREBY ORDERED AND ADJUDGED that the defendants' motion for summary judgment is GRANTED. Plaintiff's motion for reconsideration is DENIED.

DATED this 27th day of May, 1981.

/s/ Deputy Clerk  
United States District Court

## APPENDIX D

## SECURITIES ACT OF 1933

United States Code, Title 15:

“§ 77b. Definitions

When used in this subchapter, unless the context otherwise requires—

(1) The term “security” means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

## SECURITIES EXCHANGE ACT OF 1934

United States Code, Title 15:

“§ 78c. Definitions and application

(a) When used in this chapter, unless the context otherwise requires—

(10) The term “security” means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument

commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.”



JUL 5 1984

ALEXANDER L. STEVENS,  
CLERK

IN THE  
**Supreme Court of the United States**

October Term, 1983

LANDRETH TIMBER COMPANY,  
*Petitioner,*

v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
AND KATHLEEN LANDRETH  
*Respondents.*

**BRIEF IN OPPOSITION TO PETITION FOR  
A WRIT OF CERTIORARI TO THE UNITED  
STATES COURT OF APPEALS FOR  
THE NINTH CIRCUIT**

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**QUESTION PRESENTED**

Whether the sale of an entire business consummated by means of transfer of 100% of the stock of a closely held corporation and accompanied by the purchaser's complete assumption of control over the business, is a transaction withing the scope of the Securities Act of 1933 and the Securities Exchange Act of 1934?

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IN THE  
**Supreme Court of the United States**

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October Term, 1983

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LANDRETH TIMBER COMPANY,  
*Petitioner,*

v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
AND KATHLEEN LANDRETH  
*Respondents.*

---

**BRIEF IN OPPOSITION TO PETITION FOR  
A WRIT OF CERTIORARI TO THE UNITED  
STATES COURT OF APPEALS FOR  
THE NINTH CIRCUIT**

---

Respondents Ivan K. Landreth, Lucille Landreth, Thomas E. Landreth, Ivan K. Landreth, Jr., and Kathleen Landreth ("Landreths") respectfully request that the Petition for a writ of Certiorari be denied.

**STATEMENT OF THE CASE**

**A. Description of Proceedings Below**

In 1977, the Landreths sold an inoperable sawmill which was under reconstruction in Tonasket, Washington, to the corporate predecessor in interest of petitioner, Landreth Timber Company, Inc. On November 1, 1978, Landreth Timber Company, Inc. ("Landreth II") commenced an action in the Western District of Washington alleging violations of federal and state securities laws and asserting claims under state common laws in connection with the sale of the sawmill. The

district court, on Landreths' summary judgment motion, dismissed Landreth II's case for lack of federal jurisdiction. After review of the record, including admissions of fact, the district court held that Landreths' sale of the the sawmill, by transfer of 100% of the stock of a closely held, family corporation to purchasers who assumed complete control after closing, did not constitute a federal securities transaction.<sup>1</sup> The Ninth Circuit affirmed the district court.<sup>2</sup>

### B. Summary of Transactional Background

Landreths were the sole shareholders of a closely held corporation, Landreth Timber Company ("Landreth II"), which owned the sawmill.<sup>3</sup> Prior to the transaction at issue, a portion of the mill was destroyed by fire. The Landreths began to rebuild, adding modern equipment and innovations to increase production. Before construction was completed, Samuel S. Dennis III and John Bolten, Sr. expressed an interest in purchasing the mill.

Dennis and Bolten, the principal financial backers behind the purchase, were sophisticated businessmen. Dennis, as a senior partner and tax attorney at the Boston law firm of Hale and Dorr, had extensive practical experience with business acquisitions. As a co-founder, officer and director of Standex Corporation, a Fortune 500 conglomerate whose shares are traded on the New York Stock Exchange, Dennis had been involved in numerous transactions, not only as counsel for buyers and sellers of businesses, but also as a purchaser. Bolten had been the honorary chairman of the board and was a major shareholder in Standex.

Prior to closing, Dennis and Bolten conducted an extensive and meticulous pre-purchase investigation. In addition to visiting

1. The Order Granting Summary Judgment, dated April 29, 1981, is attached hereto as Appendix B.

2. The Ninth Circuit's opinion, as modified, is attached hereto as Appendix A.

3. All factual assertions are supported by the Admissions of Fact which are attached hereto as Appendix C.

the sawmill site, Dennis retained numerous local experts to assist in the investigation and negotiations. Those experts included, among others, a sawmill engineering firm which analyzed the strengths, weaknesses, capabilities and value of the mill, a certified public accountant who investigated the assets, liabilities, and performance history of the sawmill business, and a bank officer who was an expert on sawmill properties and who inspected the mill prior to providing the purchasers with financing for the transaction.

Although the transaction could as easily have been structured as an asset sale, the Landreths preferred a stock sale for tax purposes. Negotiations between the Landreths and Dennis culminated in a detailed stock purchase agreement, drafted primarily by the purchasers with the assistance of Dennis' law firm. Dennis and Bolten subsequently organized a small group of investors to form B & D Company, a Delaware corporation, to make the purchase. B & D completed the purchase according to the terms of the stock purchase agreement, and then merged with Landreth I to form Landreth II.

Upon closing, Dennis and Bolten were the only directors of Landreth II. Dennis became president, and other officers of Landreth II were designated by Dennis and Bolten.

Undisputed admissions of fact before the trial court established that Landreths retained absolutely no post-closing control over management of the business, and had no ability to determine the outcome of the purchasers' investment. (See Admissions No. 32, 38, 42-49, 56, 59, 61, 62, 64-67, 72-81, 83, 85, 87 in Appendix C.)

There was nothing "passive" about the purchasers' investment in Landreth I. Motivated by the potential for high profits in the lumber business, the purchasers embarked on an entrepreneurial program through which they intended to and did actively manage the business acquired from the Landreths. Purchasers bought all of the stock in Landreth I, and sellers retained no share interest or right to receive any post-closing profits. Purchasers' hired their own mill manager prior to closing, and proceeded to complete construction and operate

the mill according to their own business decisions. Ivan Landreth, who at the request of purchasers had signed a one-year consulting agreement, was terminated within two months of closing and had no substantive role in post-closing management. It is the position of the Landreths that the losses incurred by purchasers were due solely to their own business decisions in improperly rebuilding the mill, purchasing equipment, operating the mill, and making poor marketing decisions after closing.

In short, the sophisticated purchasers of the Landreth mill were not the sort of "passive" investors whom the securities laws were designed to protect. To the contrary, these purchasers aggressively asserted complete control over a closely held business through their acquisition of 100% of the corporate stock and subsequent management decisions. When those business decisions went awry, they sought to avail themselves of the federal securities laws, a result never intended by Congress or this Court.

### SUMMARY OF ARGUMENT

The Petition for Writ of Certiorari should not be granted for the following reasons:

1. The *Landreth* case is distinguishable from *Vista Resources, Inc. v. Seagrave Corp.*, No. 83-1084. Although certiorari was granted in *Vista Resources*, it should not be granted on the facts of the *Landreth* case.

2. The Ninth Circuit's decision was accurate and the correct result was reached for the following reasons:

(a) The Securities Act of 1933, § 2, 15 U.S.C. § 77b, and the Securities Exchange Act of 1934, § 3, 15 U.S.C. § 78c(a), both require analysis of the context of the underlying transaction in order to determine whether an instrument constitutes a "security;"

(b) The test applied by this Court in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), requires an analysis of the underlying transaction, including whether the purchaser assumes control over the outcome of the investment.

(c) The Ninth Circuit properly applied the *Howey* test; and

(d) This Court should continue to apply a transactional analysis and reject the literal approach when determining whether an instrument is a security.

3. The result reached below was fair in view of the fact that petitioner may pursue its claims in a state court forum.

### REASONS FOR DENYING THE WRIT

#### I. The Grant of Certiorari in *Vista Resources v. Seagrave Corp.* Does Not Require a Grant of Certiorari In This Case.

Petitioner cites a number of reasons in support of granting certiorari in this case, none of which are well founded.

Petitioner first argues that the grant of certiorari in *Seagrave Corp. v. Vista Resources, Inc.*, 696 F.2d 227 (2d Cir. 1982), modified, 710 F.2d 95 (1983) (per curiam), cert. granted, 52 U.S.L.W. 3185 (1984), requires a grant of certiorari in this case. It does not. In *Vista Resources*, this court necessarily will decide on a rule of law which will determine the validity of the "sale of business doctrine." Conflicting decisions of the various circuits deciding this same issue inevitably will be resolved by *Vista Resources*, rendering moot the need to grant certiorari in the instant case.

Regardless of any decision based upon the facts in the *Vista Resources* case, the *Landreth* case presents an even stronger factual pattern for holding that the federal securities acts do not apply. The facts of the *Landreth* case clearly place it outside of the federal securities laws.

As the Ninth Circuit noted, the economic realities of the *Landreth* transaction leave no doubt that the sale of 100% of the stock of the closely held corporation was a sale of a business outside the scope of federal securities laws. The following comparison of facts in *Landreth* and in *Vista Resources* demonstrates that the two cases involve dissimilar transactions and that the *Landreth* case does not involve a security transaction.



(1) The Landreths basically sold assets rather than a going concern. At the time of sale, such assets principally consisted of an inoperable sawmill under reconstruction.

(2) The sawmill and the business it generated when in operation were privately held by the Landreth family. The seller in *Vista Resources* was a publicly traded company with securities listed on the New York Stock Exchange.

(3) The principal purchasers in the *Landreth* case were Dennis and Bolten, both sophisticated businessmen. They conducted a complete and thorough investigation of the sawmill business before closing, and obtained the assistance of numerous experts, including, among others, a sawmill expert who inspected and appraised the sawmill and an accountant who reviewed mill records. The purchasers in *Vista Resources* evidently relied upon public information, 10-K and 10-Q Reports, filed with the Securities Exchange Commission, rather than their own independent investigation.

(4) The transaction could have been an asset sale or a stock sale. The final transaction, reflected in purchase documents drafted primarily by Dennis' law firm, provided for a 100% stock sale and for the resignation of all former officers and directors of Landreth Timber Company. The purchaser in *Vista Resources*, in connection with acquisition of the seller's stock, wanted no representation on the seller's board of directors because the purchase of stock was for investment purposes.

(5) The purchasers in *Landreth* were entrepreneurs who intended to, and did, actively manage and operate the sawmill business, rather than rely on the efforts of others for the production of profits. Such purchasers determined the outcome of their own investment. For instance, even before closing, Dennis, without consulting Landreth, arranged for a new sawmill general manager to be hired. Landreth was resigned to a post-closing position as a consultant, terminable at will by the company on thirty days notice. The new general manager took over mill operations immediately upon closing, and within two months gave Ivan Landreth notice that he was fired. In *Vista Resources*, there were employment contracts with existing

management, providing assurances that present personnel would continue to manage the corporation.

(6) Admitted facts before the district court undeniably established that the Landreths had *no* control over the activities or management of the sawmill after closing. Over Landreths' objections, the mill was not completed as designed before closing and substantial expenditures were made by the new manager, expenditures not contemplated before closing. The actions of the new manager substantially changed the cost of completion for mill reconstruction as well as the productive capacity of the sawmill. The Landreths' position is that the failure of the general manager to complete and operate the sawmill competently was the cause of the purchaser's unprofitability. Landreths deny, and the record before this Court does not support petitioners' assertions of misrepresentation.

Thus, the *Landreth* case is factually distinguishable and does not require a grant of certiorari to resolve the same issue raised in *Vista Resources*.

## II. The Ninth Circuit's Decision is Correct and Review by this Court is Unnecessary.

### A. The Securities Act of 1933 and the Securities Exchange Act of 1934 Require Analysis of the Underlying Transaction to Determine Whether an Instrument is a Security.

#### 1. Statutory Language Requires Consideration of the Underlying Transaction Where There is a Sale of "Stock".

The relevant language of the 1933 and 1934 Acts belies the principal argument against the sale of business doctrine -- the belief that each transaction involving anything called "stock" should necessarily be given protection under those Acts. Stock is only one of a number of types of instruments enumerated in the Acts which may be a security for statutory purposes under certain circumstances.

Even though an instrument bears a label expressly contained in the statutory definition, that definition is qualified by the condition "unless the context otherwise requires . . . .".

15 U.S.C. § 77b and 15 U.S.C. § 78c(a). Accordingly, as discussed in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), and *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), both Acts require analysis of the context of the transaction, not just the label of the instrument.

As in cases involving "notes" and certificates of deposit, the statutory language allows the Court, when dealing with "stock," to focus on factors other than simply the name and character of the instrument. See e.g., *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982); *Great Western Bank v. Korts*, 532 F.2d 1252 (9th Cir. 1976). As the Court observed in *Marine Bank*:

Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole. 455 U.S. at 560 n. 11 (emphasis added).

As discussed below, a transaction involving the sale of a business, such as the Landreths' sawmill, by the sale of 100% of a closely held corporation's stock, falls outside the definition of a security.

## 2. Congress Did Not Intend to Include the Sale of an Entire Business Within the Scope of Federal Securities Acts.

While Congress intended the term "security" to include "the many types of instruments that in our commercial world fall within the ordinary concept of a security," H.R. REP. NO. 85, 73d Cong., 1st Sess. 11 (1933), the Securities Acts were designed to protect those who turn over their capital to third parties who control the outcome of such investments, not those who are managers themselves, exercising entrepreneurial control. See Thompson, *The Shrinking Definition of a Security: Why Purchasing All of a Company's Stock is Not a Federal Security Transaction*, 57 N.Y.U.L. REV. 225, 241 (1982); H.R. REP. NO. 85, 73d Cong., 1st Sess. 2 (1933); S. REP. NO. 47, 73d Cong., 1st Sess. 7 (1933).

One of the principal aims of the bill which became the 1933 Act was:

A demand that the persons, whether they be directors, experts, or underwriters, who sponsor the investment of other people's money should be held up to the high standards of trusteeship.

H.R. REP. NO. 85, 73d Cong., 1st Sess. 3 (1933).

The investors whom Congress sought to protect are those who place their funds into the trust of others and not those who buy and control an enterprise. The purchase of an entire business, such as the *Landreth* sawmill, where the buyer acquires and exercises 100% control, is not one of the "schemes" Congress sought to regulate via the 1933 and 1934 Acts.

## 3. The Test Applied by this Court in *SEC v. W. J. Howey Co.* Requires an Analysis of the Underlying Transaction, Including Whether the Purchaser Assumes Control over the Outcome of the Investment.

To establish whether an instrument falls within the concept of a security under the 1933 Act and the 1934 Act, this Court has examined whether the transaction represents any of the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," *SEC v. W.J. Howey Co.*, 328 U.S. at 299 (emphasis added). The Court has viewed the definition of a security to be a "flexible rather than static principle" and, in *Howey*, enunciated a test which embodies the "essential attributes that run through all of the Court's decisions defining a security." *Forman*, 421 U.S. at 852. That test is comprised of three factors:

1. An investment in a common enterprise;
2. An expectation of profits; and
3. Profits which are to come solely from the efforts of others.

The "profits" to be derived solely from the efforts of others mean either "capital appreciation resulting from the development of the initial investment" or "a participation in earnings resulting from the use of investors' funds." *Forman*, 421 U.S. at 852. Where a purchaser acquires complete control of a business, such expected profits are not derived from the efforts of the seller. It is the purchaser who is in control of



the development of the initial investment or of the earnings which may result from the use of the purchaser's own funds.<sup>4</sup>

This is illustrated in the *Landreth* case where the purchasers of the sawmill thereafter controlled the hiring and firing of personnel, mill reconstruction, marketing strategy and every significant business decision — all of the factors which determined whether capital appreciation would ensue. After the sale, the Landreths were not using the funds of the purchasers with the promise of profits. Rather, they had totally divested themselves of a sawmill by means of a stock transfer, a form of sale often used as a matter of tradition or convenience, or for unrelated tax reasons.

#### 4. In *Landreth*, the Ninth Circuit Correctly Applied the *Howey* Test.

The question involving the definition of a security in the context of a sale of a business was one of first impression in the Ninth Circuit. In holding that the sale of a family business by means of a 100% stock transfer does not involve the sale of "securities" under the federal securities acts, the Ninth Circuit followed *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).<sup>5</sup> In *Forman*, this Court defined the

4. Whether control over the investment passes from seller to buyer was identified by the *Forman* Court as a crucial factor distinguishing passive investments subject to the securities laws from the *Landreth*-type acquisition:

In such cases [citing *SEC v. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943), and *Tcherepnin*, *supra*.] the investor is "attracted solely by the prospects of return" on his investment. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased — "to occupy the land or to develop it themselves," as the *Howey* Court put it — the securities laws do not apply.

421 U.S. at 852-53 (citations omitted).

5. In addition to the Ninth Circuit, the Seventh, Tenth and Eleventh Circuits have employed an "economic realities" analysis to conclude that the sale of a business is not a "security." See *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982); *Canfield v. Rapp & Son, Inc.*, 654 F.2d 459 (7th Cir. 1981); *Fredericksen v. Poloway*, 637 F.2d 1147 (7th Cir.), cert. denied, 451 U.S. 1017 (1981); *Christy v. Cambren*, 710 F.2d 669 (10th Cir. 1983); *Chandler v. Kew, Inc.*, 691 F.2d 443 (10th Cir. 1977); *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982).

parameters of federal securities laws by looking to "the economic realities underlying a transaction, and not the name appended thereto." 421 U.S. at 849.

The *Howey* test was used by the Ninth Circuit to determine whether, in economic reality, a transaction involves an instrument within the scope of the federal securities laws. That test is whether "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U.S. at 301 (emphasis added). In *Landreth*, the admitted facts demonstrated that the purchasers did not invest in a "common enterprise" with the Landreths; more importantly, instead of relying upon the sellers for their profit expectations, the purchasers exerted total control over the outcome of their investment.

The Ninth Circuit noted that the application of the *Howey* test to the acquisition of a business through purchase of stock is straightforward:

[W]hen a person purchases control of a business, he does not make an investment from which he expects profits solely from the efforts of others. Although the transaction involves stock, the economic realities reflect acquisition of a business, not passive investment, and the Acts therefore do not apply.

731 F.2d at 1352.

The Ninth Circuit correctly observed that, while the sale of business doctrine is still evolving, under any formulation of the doctrine, the economic realities of the underlying transaction involving Landreth's sawmill leave no doubt that the sale of an entire business occurred, not an investment in a security.

#### 5. This Court Should Continue to Apply a Transactional Analysis and to Reject a Literal Approach.

Analysis of the "economic realities" of the "underlying transaction" is a natural evolution of the *Howey* test, consistent with Congressional purpose and this Court's precedents. Even when holding that an instrument in a particular transaction should be deemed a security, this Court has directed that "form



should be disregarded for substance." *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967). Recognizing that a "name or description" of an instrument may be used for reasons of "tradition or convenience," the *Forman* Court expressly rejected the "literal approach." *Forman*, 421 U.S. at 848-50 (holding that purchases of "stock" in a housing corporation were not security transactions under the federal securities laws).

"Stock" with more conventional characteristics than the "stock" in *Forman* often is used as a matter of "tradition or convenience" where parties are buying or selling a business. Circuit courts which have incorrectly rejected the sale of a business doctrine have stopped their evaluation of a transaction upon determining that the instrument called "stock" has characteristics traditionally associated with stock. They have refused to look at other criteria relevant to determining the nature of the transaction<sup>6</sup>, essentially resurrecting the disfavored "literal approach."

Congress' inclusion of qualifying language ("unless the context otherwise requires") in its description of instruments which could be "securities" under the 1933 and 1934 Acts reflects the fact that, of the several dozen instruments identified, many have not traditionally been considered "securities" (e.g., "notes," "certificate of interest in a profit-sharing agreement"). See 15 U.S.C. § 77b. "Stock" is no more sacred than any other instrument identified in the Acts. The fact that an instrument bears the label, or has certain attributes, of "stock" (or a "note," or a "certificate of interest in a profit-sharing agreement") cannot determine whether the transaction is governed by the federal securities acts. It would be absurd to suggest that every instrument with the attributes of a "note" or a "certificate of interest in a profit-sharing agreement" is a security. Whether such instruments are "securities" under the Acts must depend upon transactional context. One

6. See *Golden v. Garafalo*, 678 F.2d 1139 (2d Cir. 1982); *Occidental Life Insurance Company v. Pat Ryan & Assoc., Inc.*, 496 F.2d 1255 (4th Cir.), cert. denied, 419 U.S. 1023 (1974); *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir.), cert. denied, 444 U.S. 868 (1979); *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983).

fallacy of the "literal" or "normal attributes" approach is that it fails when applied to those instruments identified in the Acts whose "normal attributes" would *not* ordinarily lead to classification as a security.

Finally, as a matter of federal policy, application of federal securities laws to the sale of a business would open the doors of the federal courts to "an escalating stream of cases where purchasers of businesses have become disillusioned with the bargains they have made." *Seagrave Corporation v. Vista Resources, Inc.*, 696 F.2d 227, 230 (2d Cir. 1982) (Lumbard, J., dissenting). Such cases, if justiciable at all, belong in the state courts.

### III. Landreth II has asserted Similar Claims in Another Forum.

Landreth II is proceeding with an action in the Superior Court for the State of Washington, King County, *Landreth Timber Company v. Ivan K. Landreth*, Civil No. 80-2-11740-8. It has asserted claims in that action for state securities law violations, breach of warranty and common law fraud. A denial of certiorari will not deprive Landreth II of its day in court.

### CONCLUSION

The petition for certiorari should be denied.

Dated this 2nd day of July, 1984.

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PEREY & SMITH

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and Kathleen Landreth

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**APPENDIX A**

**LANDRETH TIMBER COMPANY,  
Plaintiff-Appellant,**

**v.**

**Ivan K. LANDRETH and Lucille Landreth, husband and wife; Thomas E. Landreth, Ivan K. Landreth, Jr., and Kathleen Landreth, husband and wife, Defendants-Appellees.**

**No. 81-3446.**

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Sept. 8, 1982.

Decided March 7, 1984.

As Modified April 24, 1984.

Appeal from the United States District Court for the Western District of Washington.

Before BROWNING, Chief Judge, TUTTLE\* and FARRIS, Circuit Judges.

BROWNING, Chief Judge:

The issue raised in this appeal is whether sale of 100 percent of the stock of a closely-held corporation is a transaction involving a "security" within the meaning of the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa, and the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk. The district court held that it was not, relying upon the "sale-of-business" exemption from the Security Acts. We affirm.

**I.**

Defendant Ivan Landreth and his two sons were the sole shareholders of Landreth Timber Co. (Landreth I) which owned a sawmill in Tonasket, Washington. Landreth decided to sell the mill. Before a buyer could be found, a portion of the mill was destroyed by fire. Landreth began to rebuild, adding modern equipment and design innovations to increase production. Before construction was completed, Samuel Dennis, a Boston attorney representing a small group of investors, expressed an interest in purchasing the mill.

Landreth insisted on a sale of the stock of Landreth I rather than a sale of its assets. Negotiations culminated in a detailed stock purchase agreement. The purchasers formed a Delaware corporation, the B & D Company, to make the purchase. B & D completed the purchase according to the terms of the agreement. B & D then merged with Landreth I to form Landreth Timber Co. II.

Landreth declined the purchaser's offer to manage the mill but signed a one-year consulting agreement with Landreth II, terminable at will on 30-days notice. The purchasers hired a full-time manager; Landreth's post-closing role was purely advisory.

Neither Dennis nor Bolten (Dennis's principal partner) or the other investors in the group had any knowledge of the lumber industry. Their decision to purchase the mill was allegedly based on representations by Landreth as to the cost of rebuilding the mill, and its productive capacity when rebuilt.

Landreth II was unprofitable. It sold the mill, and went into receivership. Landreth II brought suit in the Western District of Washington claiming damages of \$2,500,000 for violations of the federal securities laws. The district court granted summary judgment for the Landreths on the ground that the Landreth stock was not a "security" within the meaning of the Acts.

"Stock" is among the instruments listed in the definition of "security" under the Acts,<sup>1</sup> and the district court acknowledged

1. Section 2 of the Securities Act of 1933 states: When used in this subchapter, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1) (emphasis added).

the Landreth stock had all the usual characteristics of stock. Nonetheless, the court held that under the test announced *SEC v. W.J. Howey Co.*, 328 U.S. 293, 66 S. Ct. 1100, 90 L.Ed. 1244 (1946), Landreth stock was not a "security."

*Howey* held an instrument to be an "investment contract," and thus a "security," if "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301, 66 S.Ct. at 1104. Although *Howey* did not address a transaction involving stock, the district court held it was required by *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975), to apply the *Howey* test "to all cases

#### Footnote 1 (Con't)

Section 3(a)(3) of the 1933 Act exempts

Any note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 77c(a)(3).

Section 3(a)(10) of the 1934 Act States:

(a) When used in this chapter, unless the context otherwise requires—

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10) (emphasis added).

The definition under the two Acts has been held to be "virtually identical", *Tcherepnin v. Knight*, 389 U.S. 332, 335-36, 88 S.Ct. 548, 552-53, 19 L.Ed.2d 564 (1967).



where the meaning of a 'security' is at issue." The district court held the Landreth stock was not a "security" under *Howey* because by buying 100 per cent of the stock of Landreth I, B & D Company necessarily expected to operate the business and did not expect to obtain "profits from the management or entrepreneurial efforts of others."

## II.

Whether sale of 100 percent of the stock of a closely-held corporation is a transaction involving a "security" has divided the circuits and commentators.<sup>2</sup> The Seventh,<sup>3</sup> Tenth,<sup>4</sup> and

2. Compare Seldin, *When Stock is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 Bus.Law. 637 (1982); Thompson, *The Shrinking Definition of a Security: Why Purchasing All of a Company's Stock is Not a Federal Securities Transaction*, 57 N.Y.U.L. Rev. 225 (1982); Note, *The Security Status of Stock Transfers Incident to the Purchase of a Business: The "Sale of Business" Controversy in the Aftermath of Golden v. Garafalo*, 47 Alb.L. Rev. (1983); Note, *Function Over Form: The "Security,"* 63 B.U.L.Rev. 1129 (1983); Note, *The Sale of Business Doctrine: A Decade After Forman* 49 Brooklyn L.Rev. 1325 (1983); Comment, *Acquisition of Businesses Through Purchase of Corporate Stock: An Argument for Exclusion from Federal Securities Regulation*, 8 Fla.St.U.L.Rev. 295 (1980); Note, *The Sale-of-Business Doctrine—Golden v. Garafalo*, 1983 B.Y.U.L.Rev. 201 (1983); Note, *The Second Circuit Rejects the Sale of Business Doctrine*, 57 Tul.L.Rev. 715 (1983) (all endorsing the sale of business doctrine) with Black, *Is Stock a Security? A Criticism of the Sale of Business Doctrine in Securities Fraud Litigation*, 15 U.C.D.L.Rev. 325 (1983); Hazen, *Taking Stock of Stock and the Sale of Closely Held Corporations: When is Stock Not a Security?*, 61 N.C.L.Rev. 393 (1983); Karjala, *Realignment Federal and State Roles in Securities Regulation through the Definition of a Security*, 1982 U.Ill.L.Rev. 413; Prentice & Roszkowski, *The Sale of Business Doctrine: Relief from Securities Regulation or a New Haven for Welshers?*, 44 Ohio St.L.J. 473 (1983); Rapp, *Federal Securities Laws Should Protect Some Purchases of All or Substantially All of a Corporation's Stock*, 32 Case W.Res. 595 (1982); Comment, *A Criticism of the Sale of Business Doctrine*, 71 Calif.L.Rev. 974 (1983); Note, *Repudiating the Sale-of-Business Doctrine*, 83 Colum.L.Rev. 1718 (1983); Note, 51 Wash.U.L.Q. 659 (1983) (repudiating the sale of business doctrine). See also Fitzgibbon, *What is a Security?—A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 Minn.L.Rev. 893 (1980); Note, *Recent Ninth Circuit Developments in Securities Law*, 13 Loy.L.A.L.Rev. 985 (1980); Comment,

Eleventh<sup>5</sup> circuits recognize the sale-of-business doctrine, under which a purchaser of stock who assumes control of a company is not an "investor" expecting profits from the efforts of others under the *Howey* test, and the stock purchased therefore is not a "security" within the meaning of the Acts. The Second<sup>6</sup>, Third<sup>7</sup>, Fourth<sup>8</sup>, Fifth<sup>9</sup>, and Eighth<sup>10</sup> Circuits reject the doctrine, and hold that the federal securities laws apply if the transferred instruments possess the characteristics commonly associated with stock.

## A.

Although the precise question is one of first impression in this circuit, appellees argue that we have decided it in substance in cases dealing with "notes," which, like stock, are instruments

### Footnote 2 (Con't)

*Securities Regulation: Application of the Federal Securities Laws to the Sale of a Closely Held Corporation*, 22 Washburn L.J. 406 (1983); Note, *Continuing Confusion in the Definition of a Security: The Sale of a Business Doctrine, Discretionary Trading Accounts, and Oil, Gas, and Mineral Interests*, 40 Wash. & Lee L.Rev. 1225, 1280 (1983).

3. *Sutter v. Groen*, 687 F.2d 197, 202 (7th Cir. 1982); *Canfield v. Rapp & Son, Inc.*, 654 F.2d 459, 465 (7th Cir.1981); *Frederiksen v. Poloway*, 637 F.2d 1147, 1151-52 (7th Cir.1981).

4. *Christy v. Cambron*, 710 F.2d 669, 672 (10th Cir.1983); *Chandler v. Kew, Inc.*, 691 F.2d 443, 444 (10th Cir.1977).

5. *King v. Winkler*, 673 F.2d 342, 345 (11th Cir.1982). See also *Kaye v. Pawnee Const. Co.*, 680 F.2d 1360, 1366 n. 2 (11th Cir.1982).

6. *Golden v. Garafalo*, 678 F.2d 1139, 1144 (2d Cir.1982); *Seagrave Corp. v. Vista Resources, Inc.*, 696 F.2d 227, 229 (2d Cir.1982).

7. *Glick v. Campagna*, 613 F.2d 31, 35 n. 3 (3d Cir.1979) (Court not persuaded Congress intended acts to apply to small close corporations, but "a literal reading of the statute and governing precedent" indicate the Acts apply).

8. *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202, 1204 (4th Cir.1979); *Occidental Life Ins. Co. v. Pat Ryan & Assocs., Inc.*, 496 F.2d 1255, 1261 (4th Cir.1974).

9. *Daily v. Morgan*, 701 F.2d 496 (5th Cir.1983).

10. *Cole v. PPG Indus.*, 680 F.2d 549, 555-56 (8th Cir.1982)(interpreting Arkansas law).

well-known in commerce and specifically listed in the statutory definition of a "security."

We have applied a "risk capital" test to determine whether in a particular transaction a note is a "security" under the Acts<sup>11</sup>. Under this test, a note is a "security" if it reflects "a contribution of risk capital subject to the entrepreneurial or managerial efforts of others." *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1257 (9th Cir. 1976), quoting *El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1229 (9th Cir. 1974). The test distinguishes investment transactions, which are covered by the Act, see *United States v. Carman*, 577 F.2d 556, 563 n. 9 (9th Cir. 1978), for routine commercial transactions, which are not, see e.g., *Great Western Bank*, 532 F.2d at 1257.

The sale-of-business doctrine rests upon the premise that the Acts apply only to investment transactions, and not to commercial or entrepreneurial transactions. See e.g., *Sutter v. Groen*, 687 F.2d at 201. The doctrine derives from *Forman*, in which the Court stated:

The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors.

421 U.S. at 849, 95 S.Ct. 2059. The court added "Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto." *Id.* The doctrine looks to the *Howey* test to determine whether in "economic reality" the transaction involves an investment. Under *Howey*, as the district court noted, the test is whether "the scheme involves an investment of money in

11. See *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426 (9th Cir. 1978) ("promissory note" and other instruments); *United California Bank v. THC Financial Corp.*, 557 F.2d 1351 (9th Cir. 1977) ("put" letter and accompanying notes); *Great W. Bank & Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976) (unsecured "demand note"); *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224 (9th Cir. 1974).

a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301, 66 S.Ct. at 1104.

The application of the *Howey* test to the acquisition of a business through purchase of stock is straightforward: when a person purchases control of a business, he does not make an investment from which he expects profits solely from the efforts of others. Although the transaction involves stock, the economic realities reflect acquisition of a business, not passive investment, and the Acts therefore do not apply. Cases that reject the sale-of-business doctrine look only to the nature of the instruments involved: if they possess the ordinary characteristics of stock, they are "securities" and within the coverage of the Acts without regard to the nature of the underlying transaction.

In contrast, both the sale-of-business doctrine and the risk capital test follow *Forman* and reject a literal reading of the statute in favor of an inquiry into the economic realities of the underlying transaction. Both include a transaction only if it involves "an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301, 66 S.Ct. at 1104. Both exclude essentially "commercial" transactions in which there is no "investment." Thus, risk capital cases and cases endorsing the sale-of-business doctrine interpret the Acts in precisely the same way.

We see no principled way to justify an analysis in which we determine whether a note is a "security" within the meaning of the Acts by examining the transaction in light of the statutory purpose, but determine whether stock is a "security" by examining only the instrument and not the transaction in light of the statutory purpose. We therefore conclude that adherence to the principle of construction adopted in our "note" cases requires adherence to the "sale-of-business" exclusion from the Securities Acts of the purchase of 100 per cent of the stock of a closely-held corporation.

## B.

The sale-of-business doctrine is still evolving, and its contours remain in some respects uncertain. However, under any



formulation of the doctrine, the economic realities of this transaction leave no doubt that the district court reached the correct result, at least with respect to the sole appellant in this case, Landreth II.

As to Landreth II, the underlying transaction involved the sale of an entire business, effected through a sale of 100 per cent of the corporation's stock. Following the transaction, Landreth II had full control of the corporation, including the day-to-day operations of the mill and its employees. In "economic reality," the underlying transaction was a sale of a lumber business and, under the sale-of-business doctrine, was not an investment in a "security."

Appellant suggests summary judgment was inappropriate because there were disputed issues of fact with regard to Landreth's post-closing managerial role. Appellant asserts it purchased the Landreth stock only because it believed Landreth would supervise the enterprise without participation by members of the purchasing group until the mill was completed and profitable operations were underway. The uncontested facts belie this assertion. Purchasers attempted to convince Landreth to continue as manager of the mill, but he refused. Appellant employed its own manager who assumed effective control of the business. Landreth agreed to serve only as a consultant, and for no more than one year; even these services were terminable at the will of appellant. Neither Landreth nor appellant's manager can be regarded as a third-party upon whose efforts the purchaser relied for its profit within the meaning of *Howey*. *Bitter v. Hoby's International, Inc.*, 498 F.2d 183, 186 (9th Cir.1974).

### III.

While this appeal was pending Landreth II moved to add as plaintiffs Dennis, and Bolten individually and as the administrator of the estate of his wife, Katharine S.A. Bolten. Although appellant brought this motion under Fed.R.Civ.P. 19 to add parties plaintiff, in substance it is a motion to intervene under Fed. R.Civ.P. 24 since the parties to be added are appellant's controlling stockholders. A court of appeals may

permit intervention where none was sought in the district court "only in an exceptional case for imperative reasons," *McKenna V. Pan American Petroleum Corp.*, 303 F.2d 778, 779 (5th Cir.1962). Intervention is sought without stating any reason for failure to intervene in the district court beyond the fact that intervention would permit the additional parties to avail themselves of the doctrine recognized in *Sutter V. Groen*, 687 F.2d 197 (7th Cir.1982), decided after this appeal was filed. Bolten and Dennis were obviously aware of defendants' reliance on the sale-of-business doctrine in the district court. No "imperative reason" has been advanced to allow intervention at this late date. As appellees point out, intervention would raise new issues of fact and law not before the district court. See *Spangler v. Pasadena City Board of Education*, 552 F.2d 1326, 1328 (9th Cir.1977). The motion is denied.

The judgment is affirmed.



APPENDIX B

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

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No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

v.

IVAN K. LANDRETH AND LUCILLE LANDRETH,  
husband and wife; THOMAS E. LANDRETH, IVAN K.  
LANDRETH, Jr., and KATHLEEN LANDRETH,  
husband and wife,  
*Defendants.*

IVAN K. LANDRETH AND LUCILLE LANDRETH,  
husband and wife; THOMAS E. LANDRETH, IVAN K.  
LANDRETH, Jr., and KATHLEEN LANDRETH,  
husband and wife,  
*Counterclaim Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim Defendant.*

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ORDER GRANTING SUMMARY JUDGMENT

THIS MATTER comes before the Court on cross-motions for summary judgment. Oral argument was heard on February 27, 1981. At the conclusion of that hearing, the Court indicated its inclination to grant summary judgment in favor of the defendants and asked counsel to submit a list of admitted facts bearing on the issue of managerial control. Subsequent to the hearing, counsel submitted admitted facts and supplemental memoranda regarding managerial control. Having considered the motions, memoranda, affidavits, admitted facts, and being fully advised, the Court now finds and rules as follows:

This is an action by the plaintiff Landreth Timber Company to recover for violation of the federal securities laws,<sup>1</sup> state securities laws and state common law. The issue presented is whether the sale of 100% of the stock of a closely-held corporation is a transaction covered by the federal securities laws. This Court joins a growing majority in holding that the federal securities laws do not apply.

Summary judgment is proper where there is no genuine issue of material fact or where viewing the evidence and the inferences which may be drawn therefrom in the light most favorable to the adverse party, the movant is clearly entitled to prevail as a matter of law. *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1254 (9th Cir. 1976); *Marx v. Computer Services Corp.*, 507 F.2d 485, 487 (9th Cir. 1974). A factual issue is immaterial if resolution of the issue is not necessary in order for the court to reach its decision. *Cordas v. Specialty Restaurants*, 470 F. Supp. 780 (D. Ore. 1979).

The material facts in this case are undisputed. The defendants sold 100% of the stock of the Landreth Timber Company to the plaintiff's predecessor-in-interest. The stock possessed the ordinary characteristics of stock. The two principal financial backers behind the purchase, Samuel S. Dennis and John Bolten Sr., were not knowledgeable in any aspect of the lumber industry.

Prior to closing the transaction, the purchasers retained Phil Cook to be general manager of the mill after closing. On the closing date, November 17, 1977, two agreements were entered into: (1) a stock purchase agreement which transferred 100% of the stock and required the defendants to deliver to the purchasers the signed resignations of all the officers and directors of the Landreth Timber Company, and (2) a consulting agreement between Ivan K. Landreth Sr. and the purchasers. The nature and scope of Landreth's post-closing role as consultant was defined in the consulting agreement as follows:

1.2 *Consulting Duties, Etc.* The Company shall employ the consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as a consultant to the Company in connection with such participation and for such purposes.

Pursuant to this agreement, Landreth's role was purely advisory; the authority to make any and all managerial decisions was transferred to Phil Cook and, ultimately, to the purchasers. The consulting agreement also provided that Landreth's post-closing employment was terminable by plaintiff at will upon thirty days' prior written notice.

Subsequent to closing the transaction, it allegedly became apparent that numerous misrepresentations had been made by the defendants during the course of negotiations. The plaintiff terminated the consulting agreement with Landreth and filed this action.

The threshold issue in this case is whether the stock involved is a "security." The parties agree that a transaction evidence by the sale of stock is not necessarily a security transaction simply because the statutory definition of a security includes the words "any . . . stock." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 848 (1974). Rather, the courts adhere to the principle that "in searching for the meaning and scope of the work "security" in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

What, then, are the relevant "economic realities" that must be examined? How closely should a court examine a stock before determining whether it is a "security"? It is here that the parties differ. The plaintiff contends that the Court should constrain itself to examining the characteristics of the stock itself. The plaintiff points out the Landreth stockholders have the following rights: receiving notice of any shareholders' meeting; electing and removing directors and filling vacancies;

<sup>1</sup> Section 12 (1), 12(2), and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 771(1), 771(2) and 77q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5 of the Securities Exchange Commission, 17 CFR § 250.10b-5.



receiving certificates representing their ownership interest; transferring shares to a third party; receiving declared dividends; amending by-laws; and all rights granted to shareholders by Washington law. The plaintiff argues that these traditional characteristics of stock would lead a reasonable purchaser to assume that the securities laws would apply and, therefore, the Court should look no further.

The defendants, on the other hand, urge the Court to look beyond the characteristics of stock to the economic realities of the underlying transaction. They contend that the transaction at issue was essentially the sale of a business, through the transfer of stock, and that such a transaction is not within the purview of the federal securities laws.

This issue can be resolved only after a careful reading of the Supreme Court's decision in *Forman, supra*. In *Forman*, residents of a cooperative housing project, who had been required to purchase "stock" in the housing cooperative in order to acquire a residential unit, filed an action for fraud under the federal securities laws. The Court held that the shares of stock did not constitute "securities" within the meaning of those laws.

In part "A" of the *Forman* opinion, the Court rejected the argument that a transaction, evidenced by the sale of shares called "stock," must be considered a security transaction simply because the statutory definition of a security includes the words "any . . . stock." 421 U.S. at 848. In doing so, the Court emphasized the purposes underlying the federal securities laws.

The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. 421 U.S. at 849.

The Court concluded that the "stock" before it was not a "security" within the meaning of the federal securities laws. In doing so, the Court relied both on the fact that the shares

did not possess the characteristics traditionally associated with stock (e.g. no dividends, no right to pledge or hypothecate, no voting right), and on the fact that the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit. 421 U.S. at 851.

In part "B" of the opinion, the Court rejected the Court of Appeals' conclusion that a share in the housing cooperative was an "investment contract" as defined by the Securities Acts, and rejected the plaintiffs' further argument that in any event what they agreed to purchase is "commonly known as a 'security'" within the meaning of those laws. The Court stated:

In considering these claims we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a 'security'." In either case, the basic test for distinguishing the transaction from other commercial dealings is

"whether the scheme involves and investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301.

This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture promised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. 421 U.S. at 852.

Three aspects of the above-quoted passage should be noted in particular. First, the Court states that "we *again* must examine the substance—the economic realities of the transaction . . ." (emphasis added). This is a further indication that the Court in part "A" was looking to the economic realities of the underlying transaction, and not simply examining the characteristics of the stock instruments themselves. Second, the Court indicates a distinction between security transactions and "other commercial dealings." As the Court states later in the same paragraph, in a securities transaction the investor is attracted solely by the prospect of a return on his investment. 421 U.S. at 852.



By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or develop it themselves" as the *Howey* Court put it, *ibid.*—the securities laws do not apply. 421 U.S. at 852-53.

Finally, it should be noted that the Court states that the *Howey* test "embodies the essential attributes that run through all of the Court's decisions defining a security." (emphasis added). This is a strong indication that the Court intends that the *Howey* test be generally applicable to all cases where the meaning of "security" is at issue, not just cases involving the definition of "investment contract." This conclusion is further supported later in the *Forman* opinion where the Court states:

What distinguished a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others. . . 421 U.S. at 858.

For these reasons, this Court concludes: (1) that it must look beyond the characteristics of the stock itself to the economic realities of the underlying transaction, (2) that it must bear in mind a distinction between security transactions and other commercial dealings, and (3) that the *Howey* test focuses on the relevant "economic realities" and is applicable in determining whether a stock transaction is within the purview of the federal securities laws. These conclusions comport with the majority of post-*Forman* decisions. *Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir. 1981); *Chandler v. Kew*, Fed. Sec. L. Rptr. ¶ 96,966 (10th Cir. 1977); *Bula v. Mansfield*, Fed. Sec. L. Rptr. ¶ 96,964 (D. Col. 1977); *Dueker v. Turner*, Fed. Sec. L. Rptr. ¶ 97,535 (D. Geo. 1979); *Anchor-Darling Industries v. Leonard Suozzo*, No. 79-4085, E.D. Penn., March 16, 1981; *Barsy v. Verin*, No. 79 C 3323, N.D. Ill., February 25, 1981. But see *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir. 1979); *Titsch Printing, Inc. v. Hastings*, 456 F. Supp. 445 (D. Col. 1978); *Bronstein v. Bronstein*, 407 F. Supp. 925 (E.D. Penn. 1976).

In applying the *Howey* test, this Court need only determine whether the third requirement has been met, whether the purchasers were led to expect profits from the managerial or entrepreneurial efforts of others. This determination must be

made based on the factual circumstances at the time of the agreement and not on facts occurring subsequent to the agreement. *El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1228 (9th Cir. 1974). It also irrelevant for the purchasers to argue that they relied on Landreth's past efforts to build up the business. As the Seventh Circuit stated in *Emisco Industries v. Pro's Inc.*, 543 F.2d 38 (7th Cir. 1976):

This only repeats plaintiffs' allegation of reliance upon misrepresentations made during the purchase. The important element for the transaction to constitute an investment is that [the purchaser] relied on the present and future efforts of another to produce profits. 543 F.2d at 41.

Thus, events occurring prior to the agreement are relevant only insofar as they indicate whether the purchasers, as of the date of the agreement, were led to expect profits resulting from the future entrepreneurial or managerial efforts of others.

The purchasers argue that the third requirement of *Howey* has been met because they were led to expect profits from the efforts of Landreth and Cook. In other words, the purchasers argue that Landreth and Cook are "others" for purposes of the third requirement of the *Howey* test.

This argument exalts a literal reading of the *Howey* test over the purposes of the federal securities laws. The fundamental purpose of those laws is to protect those who place their money in the hands of someone over whom they exercise little or no control. Persons or entities who are beyond the control of the purchaser are "others" within the meaning of *Howey* and *Forman*. Employees, including managers and consultants, are not. *Bitter v. Hoby's International Inc.*, 498 F.2d 183 (9th Cir. 1974). In the words of the Ninth Circuit in *Bitter*:

For the manager to be a "third party," within the meaning of the *Howey* test, the manager must be outside of the direct and immediate control of the franchise. 498 F.2d at 186.

In the present case, both Landreth and Cook, as employees, were under the direct and immediate control of the purchasers after the sale and, therefore, they are not "others" or "third parties" within the meaning of *Howey* and *Forman*. Because

there are no "others" involved in this case, it is not necessary to apply the analysis in *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973).<sup>2</sup>

For these reasons, the motion for reconsideration is DENIED and the defendants' motion for summary judgment is GRANTED.

IT IS SO ORDERED.

The Clerk of this Court is directed to send uncertified copies of this Order to all counsel of record.

DATED at Seattle, Washington, this 29th day of April, 1981.

/s/ Barbara J. Rothstein  
United States District Judge

<sup>2</sup> In *Turner*, the promoter/seller was beyond the control of the purchasers and, therefore, it was an "other" or "third party" within the meaning of *Howey*. This made it necessary to analyze whether the undeniably significant efforts were those of the purchasers or those of the promoter. But, in the present case, Landreth and Cook are not "others" because they were within the control of the purchasers and, therefore, there is no occasion to analyze whether the undeniably significant decisions were made by Landreth, Cook, or the purchasers.

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

LANDRETH TIMBER )  
COMPANY, INC. )  
Plaintiff, )

vs. )

IVAN K. LANDRETH and )  
LUCILLE LANDRETH, et al., )  
Defendants. )

IVAN K. LANDRETH and )  
LUCILLE LANDRETH, husband )  
and wife, et al., )  
Counterclaim Plaintiffs, )

vs. )

LANDRETH TIMBER )  
COMPANY, INC., )  
Counterclaim Defendants. )

CIVIL ACTION

NO. C78-663R

DEFENDANT'S  
REQUESTS TO  
PLAINTIFFS FOR  
ADMISSIONS OF  
FACT  
CONCERNING  
POST-CLOSING  
CORPORATE  
CONTROL

DOCKETED

TO: Landreth Timber Company, Inc., and its attorney, John W. Hathaway, EDWARDS & BARBIERI

Pursuant to Court order and Rule 36 of the Federal Rules of Civil Procedure, you are hereby requested to admit to or specifically deny the truth of the matters set forth below on or before March 25, 1981. You are reminded that FRCP 36 requires that "[a] denial shall fairly meet the substance of the requested admission, and when good faith requires that a party qualify his answer or deny only a part of the matter of which an admission is requested, he shall specify so much of it as is true and qualify or deny the remainder.

**Definitions**

1. The term "plaintiff" refers to plaintiff/counterclaim defendant Landreth Timber Company, Inc.
2. The term "defendants" refers to defendants/counterclaim plaintiffs Ivan K. Landreth and Lucille Landreth, husband and



wife; Thomas E. Landreth; and Ivan K. Landreth, Jr. and Kathleen Landreth. Unless otherwise indicated, the name "Landreth" or "Ivan Landreth" refers to Ivan K. Landreth.

3. The term "Dennis" refers to Samuel S. Dennis III of Newton, Massachusetts, buyer under the Stock Purchase Agreement dated October 6, 1977.

4. The term "closing" refers to November 17, 1977, the date on which the sale of Landreth Timber Company, Inc. by defendants to B & D Company, Inc., plaintiff's predecessor in interest, was consummated.

### REQUESTS FOR ADMISSIONS

1. Attached hereto are true, correct, and authentic copies of the following documents:

a) Executed Stock Purchase Agreement dated October 6, 1977.

b) Executed Assignment Of, And Amendment To, Stock Purchase Agreement dated November 16, 1977.

c) Executed Articles of Merger of Landreth Timber Company, Inc. into B & D Company, Inc. dated November 17, 1977.

(d) Executed Agreement And Plan of Merger of Landreth Timber Company, Inc. into B & D Company, Inc. dated November 17, 1977.

(e) Executed Resignation of Officers of Landreth Timber Company, Inc. dated November 17, 1977.

(f) Executed Resignation of Directors of Landreth Timber Company, Inc. dated November 17, 1977.

(g) Document numbers 11001969 through 11002041, consisting of stock certificates and related assignments having as their cumulative effect the vesting of ownership of Landreth Timber Company, Inc. stock after November 17, 1977, in Dennis, Lillian W. Dennis, John Bolten, Sr., John Bolten, Jr., Katherine S. Bolten, Jack P. Branch, Robert E. Branch, Al Willard, Isabel Willard, Troy Beaver, Sr., and Troy Beaver, Jr.

(h) Action of Sole Director (Dennis) dated November, 1977 (Document numbers 11002296-97).

(i) Letter from Jack P. Branch to Dennis dated October 20, 1977 with resume attachments (Document numbers 11003155-61; Deposition Exhibit 31).

(j) Letter from Jack Branch to Ivan Landreth dated October 27, 1977 (Document number 41000053-54; Deposition Exhibit 115).

(k) Letter from Jack Branch to Phil Cook dated December 19, 1977 (Document number 11003314; Deposition exhibit 294).

(l) Certificates of President signed by Dennis and dated November 17, 1977 (Document number 11002330).

(m) Letter from Dennis to Supervisor, Colville National Forest, dated November 17, 1977 (Document number 11002331).

(n) Letter from Jack Strother to Ivan Landreth dated March 3, 1978 (Document number 61000067).

(o) Letter from Ivan Landreth to Jack Strother dated January 16, 1978 (Document numbers 61000219-21).

(p) Executed Consulting and noncompetition Agreement effective November 17 (Document numbers 11002177-180).

(q) Letter from Jack Branch to Ivan Landreth dated January 10, 1978 (Document Exhibit 298).

(r) Letter from Jack Branch to Dennis and John Bolten dated November 21, 1977 (Document numbers 11003242-43; Deposition Exhibit 285).

(s) Letter from Jack Branch to Dennis and John Bolten dated November 28, 1977 (Document numbers 11003244-45; Deposition Exhibit 286).

(t) Letter from Jack Strother to Phil Cook dated December 1, 1977 (Document number 11004196).

(u) Letter from Dennis to Jack Branch dated December 1, 1977 (Document number 11003257; Deposition Exhibit 287).

(v) Letter from Jack Branch to Dennis and John Bolten dated December 6, 1977 (Document numbers 11003269-71; Deposition Exhibit 288).

(w) Letter from Dennis to Phil Cook dated December 7, 1977 (Document number 11003277; Deposition Exhibit 290).

(x) Letter from Dennis to Phil Cook dated December 7, 1977 (Document numbers 1003274-76; Deposition Exhibit 291).

(y) Letter from Jack Branch to Dennis dated December 12, 1977 (Document numbers 11003282-85; Deposition Exhibit 292).



(z) Letter from Dennis to Phil Cook dated December 13, 1977 (Document number 11003287).

(aa) Letter from Dennis to John Bolten dated December 16, 1977 (Document numbers 11003302-05; Deposition Exhibit 296).

**RESPONSE:**

Admit.

2. As of October 5, 1977, one hundred percent (100%) of the outstanding stock of Landreth Timber Company, Inc. was owned by defendants Ivan K. Landreth, Ivan K. Landreth, Jr., and Thomas E. Landreth.

**RESPONSE:**

Admit.

3. As of October 5, 1977, the most valuable physical asset of Landreth Timber Company, Inc., was a lumber manufacturing facility under reconstruction in Tonasket, Washington.

**RESPONSE:**

Admit.

4. Under the terms of a Stock Purchase Agreement dated October 6, 1977, Ivan K., Landreth, Ivan K. Landreth, Jr., and Thomas E. Landreth, as sellers, agreed to sell one hundred percent (100%) of the outstanding stock in Landreth Timber Company, Inc. to Samuel S. Dennis III ("Dennis") as buyer.

**RESPONSE:** Deny insofar as request assumes parties contemplated that Dennis executed stock purchase agreement in individual capacity. Admit that, under the terms of the stock purchase agreement, defendants agreed to sell 100% of the outstanding (continued on attached sheet)

5. Closing of the Stock Purchase Agreement occurred on November 17, 1977.

**RESPONSE:**

Admit.

6. Under the terms of an Assignment of, And Amendment To, Stock Purchase Agreement dated November 16, 1977, Dennis assigned his interest in Landreth Timber Company, Inc. to B & D Company, Inc.

**RESPONSE:**

(see answer on attached sheet)

7. B & D Company, Inc. is a Delaware corporation which was formed pursuant to the direction of Dennis, or his business partners or agents.

**RESPONSE:**

(see answer on attached sheet)

8. Under the terms of an Agreement and Plan of Merger dated November 17, 1977, Landreth Timber Company, Inc. was merged into B & D Company, Inc.

**RESPONSE:**

Admit.

9. The merger of Landreth Timber Company, Inc. into B & D Company, Inc. was effected pursuant to the direction of Dennis, or his business partners or agents.

**RESPONSE:**

(see answer on attached sheet)

10. Upon consummation of the merger of Landreth thereafter continued to conduct the sawmill business as Landreth Timber Company, Inc.

**RESPONSE:**

Admit.

11. None of the defendants were officers, directors, shareholders, or employees of B & D Company, Inc.; nor did said defendants have any financial interest of any kind in B & D Company, Inc.

**RESPONSE:**

Admit.

12. Prior to closing, the officers of Landreth Timber Company, Inc. consisted of Ivan K. Landreth as President, and Lucille Landreth as Vice-President and Secretary-Treasurer.

**RESPONSE:**

Admit.

13. Prior to closing, the entire Board of Directors of Landreth Timber Company, Inc. consisted of Ivan K. Landreth, Lucille Landreth, and Thomas E. Landreth.

**RESPONSE:**

Admit.

14. Paragraph 4(b)(3) of the Stock Purchase Agreement required the sellers of Landreth Timber Company to deliver to buyer at closing the signed resignations of all officers and directors of the company.

**RESPONSE:**

Admit.

15. At closing on November 17, 1977, Ivan K. Landreth executed a written resignation as president of Landreth Timber Company, and Lucille Landreth executed a written resignation as vice-president and treasurer of the company.

**RESPONSE:**

Admit.

16. At closing On November 17, 1977, Ivan K. Landreth Lucille Landreth, and Thomas E. Landreth resigned as directors of Landreth Timber Company.

**RESPONSE:**

Admit.

17. Prior to November 17, 1977, Dennis assembled a group of individuals to hold stock in Landreth Timber Company after closing of the sale; none of the defendants were included in this group.

**RESPONSE:** Deny that Dennis assembled the purchasing group. Admit that defendants purchased no shares in B & D Company, Inc. or in the successor Landreth Timber Co., Inc.

18. After closing on November 17, 1977, two classes of Landreth Timber Company stock existed. Class A stock was owned by Dennis, Lillian W. Dennis, John Bolten, Sr., John Bolten, Jr., and Katherine S. Bolten. Class B stock was owned by Jack P. Branch, Robert E. Branch, Al Willard, Isabel Willard, Troy Beaver, Sr., and Troy Beaver, Jr.

**RESPONSE:**

Admit.

19. After closing, none of the defendants were officers, directors, or shareholders in Landreth Timber Company.

**RESPONSE:**

Admit.

20. After closing, none of the defendants retained any ownership interest in Landreth Timber Company.

**RESPONSE:** Admit that defendants had no stock ownership interest in Landreth Timber Company after closing.

21. After closing, none of the defendants had any right to share in profits or losses of Landreth Timber Company.

**RESPONSE:**

(see answer on attached sheet)

22. After closing, none of the defendants, other than Ivan Landreth, had any employment relationship with Landreth Timber Company or were involved in any respect with the operation of the company.

**RESPONSE:**

Admit.

23. Immediately after closing, the board of directors of Landreth Timber Company consisted of Dennis and John Bolten, Sr.

**RESPONSE:**

Admit.

24. Immediately after closing, the officers of Landreth Timber Company consisted of John Bolten, Sr., chairman of the board; Dennis, president and treasurer; Jack G. Strother, secretary; and Ruth A. Weymouth, assistant secretary.

**RESPONSE:**

Admit.

25. Prior to closing, Jack Branch began searching for a General Manager to replace Ivan Landreth after closing.

**RESPONSE:** Admit that Jack Branch began searching for a general manager prior to closing. Deny that the general manager was to replace Ivan Landreth.

26. Jack Branch was acting on behalf of Dennis in attempting to locate a General Manager.



**RESPONSE:** Deny that Jack Branch was acting on behalf of Dennis in attempting to locate a general manager. Admit that Jack Branch acted on behalf of purchasers.

27. By letter dated October 20, 1977, Jack Branch advised Dennis that his search for a new General Manager had narrowed to three candidates, one of which was Phil Cook.

**RESPONSE:**  
Admit.

28. Between October 20, 1977 and closing on November 17, 1977, Dennis' purchasing group selected and retained Phil Cook to be General Manager of Landreth Timber Company after closing.

**RESPONSE:**  
Admit.

29. Prior to closing, Landreth provided the purchasers with the name of an individual he recommended as a possible general manager. This individual was not Phil Cook.

**RESPONSE:**  
(see answer on attached sheet)

30. Ivan Landreth did not in fact participate in the decision to hire Phil Cook as General Manager.

**RESPONSE:**  
(see answer on attached sheet)

31. By letter dated October 27, 1977, Jack Branch informed Ivan Landreth that Phil Cook had been hired to be the new General Manager after closing, and requested that Landreth extend "all courtesies to Phil in any interim meetings that you will have with him prior to our formal take over" after closing.

**RESPONSE:**  
Admit.

32. After closing, Phil Cook immediately assumed the position of General Manager of Landreth Timber Company operations.

**RESPONSE:**  
Admit.

33. Ivan Landreth's role with Landreth Timber Company after closing was as a consultant pursuant to the terms of a

Consulting and Non-Competition Agreement dated November 17, 1977.

**RESPONSE:**  
Admit.

34. Ivan Landreth had no job title with Landreth Timber Company after closing.

**RESPONSE:**  
Deny.

35. The nature and scope of Ivan Landreth's post-closing role as consultant were defined by paragraph 1.2 of the Consulting Agreement, to wit:

1.2. *Consulting Duties, etc.* The Company shall employ the Consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the Consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as consultant to the Company in connection with such participation and for such purposes.

**RESPONSE:**  
Admit.

36. Ivan Landreth's compensation as a consultant was on a fixed monthly salary plus expenses with no profit sharing, commissions, or other components.

**RESPONSE:**  
Admit.

37. Paragraph 2.2 of the Consulting Agreement defined the circumstances under which Landreth Timber Company would reimburse Ivan Landreth for expenses incurred by him in his role as a consultant, to wit:

2.2 *Reimbursement of Costs and Expenses.* Consultant will be reimbursed for his reasonable costs and expenses in connection with the performance of services specifically requested by the Company upon reasonable substantiation and approval by the Company of such costs and expenses.

**RESPONSE:**  
Admit.



38. Paragraph 8(c) of the Consulting Agreement provided that Ivan Landreth's post-closing employment was terminable by plaintiff at will upon thirty days prior written notice.

**RESPONSE:**

Admit.

39. After closing, Jack Branch monitored construction progress and operations at the mill, and reported periodically to Dennis and Bolten concerning the same.

**RESPONSE:**

(see answer on attached sheet)

40. By letter dated November 21, 1977, Jack Branch reported to Dennis and Bolten concerning certain events related to "the transition" during the first several days after closing, stating among other things:

"[I]t was very gratifying to see a take-charge guy like Phil Cook showing his real leadership capabilities and literally snapping them [the employees] to and starting to run the show like a real business. I do feel you can be proud of Phil Cook and his business-like manner and overall leadership."

**RESPONSE:**

(see answer on attached sheet)

41. Two days after closing, Phil Cook excluded Ivan Landreth from a meeting with representatives of Warren & Brewser, the maxi-mill supplier.

**RESPONSE:**

Deny.

42. After closing, Landreth Timber Company and Phil Cook possessed the authority to hire or fire employees without the permission or concurrence of Ivan Landreth.

**RESPONSE:**

Admit.

43. After closing, Ivan Landreth did not possess the authority to hire or fire employees without the permission or concurrence of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

44. After closing, Ivan Landreth did not in fact hire or fire any Landreth Timber Company employees.

**RESPONSE:**

Admit.

45. After closing, Landreth Timber Company possessed the authority to set or change employee salary levels without the permission or concurrence of Ivan Landreth.

**RESPONSE:**

Admit.

46. After closing, Ivan Landreth did not possess the authority to set or change employee salary levels without the permission or concurrence of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

47. After closing, Ivan Landreth did not in fact set or change any salary levels for Landreth Timber Company employees.

**RESPONSE:**

Admit.

48. After closing, Phil Cook possessed the authority to enter into new timber purchase contracts without the permission or concurrence of Ivan Landreth.

**RESPONSE:**

Admit.

49. After closing, Ivan Landreth did not possess the authority to enter into new timber purchase contracts without the permission or concurrence of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

50. After closing, Ivan Landreth did not in fact enter into any new timber purchase contracts on behalf of Landreth Timber Company.

**RESPONSE:** Admit that defendant Landreth signed no such contracts. Deny that defendant Landreth did not participate in bidding on, and acquiring, such contracts on behalf of plaintiff.

51. Prior to closing, Landreth Timber Company purchased timber from the United States Forest Service.

**RESPONSE:**

Admit.

52. Paragraph 2(j) of the Stock Purchase Agreement stated that Landreth Timber Company had in the past purchased "most" of its timber requirements from the Forest Service.

**RESPONSE:**

Admit.

53. By letter dated November 17, 1977, Dennis informed the Forest Service that Landreth Timber Company had been sold to a new purchasing group, that Dennis was the controlling stockholder and that Phil Cook was "the new General Manager of all operations at Landreth Timber Company."

**RESPONSE:**

Admit.

54. By an instrument entitled "Certificate of President" dated November 17, 1977, Dennis attested that the following resolution was adopted by all of the new directors of Landreth Timber Company:

**RESOLVED:** That Phillip A. Cook, as General Manager of the Company's operations, is hereby designated and authorized as the Company's representative to deal with the United States Forest Service and to execute all documents in connection with timber cutting contracts and any and all matters between Forest Service and the Company.

**RESPONSE:**

Admit.

55. After closing, Landreth Timber Company and Phil Cook possessed the authority to make decisions for Landreth Timber Company concerning product mix, product sales, and sale terms without the permission or concurrence of Ivan Landreth.

**RESPONSE:**

(see answer on attached sheet)

56. After closing, Ivan Landreth did not possess the authority to make decisions for Landreth Timber Company concerning product mix, product sale prices, or sale terms without the permission or concurrence of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

57. After closing, Ivan Landreth, did not in fact make or implement any decisions for Landreth Timber Company concerning product mix, product sale price, or sale terms on behalf of Landreth Timber Company.

**RESPONSE:**

Admit.

58. After closing, Landreth Timber Company and Phil Cook possessed the authority to make decisions concerning expenditures for equipment acquisitions and maintenance without the permission or concurrence of Ivan Landreth.

**RESPONSE:** Deny that Cook was not required to confer with defendant Landreth concerning expenditures for equipment acquisitions and maintenance. Admit that, after conferring with defendant Landreth, Cook was authorized to make these decisions on behalf of plaintiff.

59. After closing, Ivan Landreth did not possess the authority to make decisions for Landreth Timber Company concerning expenditures for equipment acquisitions and maintenance without the permission or authority of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

60. After closing, Ivan Landreth did not in fact make or implement any decisions for Landreth Timber Company concerning expenditures for equipment acquisitions or maintenance.

**RESPONSE:**

Deny.

61. After closing, Landreth Timber Company and Phil Cook possessed the authority to make decisions concerning construction, design, or redesign of the sawmill without the permission or concurrence of Ivan Landreth.

**RESPONSE:** Deny that Cook was not required to confer with defendant Landreth concerning construction and design of the



facility. Admit that, after conferring with defendant Landreth, Cook was authorized to make these decisions on behalf of the plaintiff.

62. After closing, Ivan Landreth did not possess the authority to make decisions for Landreth Timber Company concerning construction, design, or redesign of the sawmill without the permission or concurrence of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

63. After closing, Ivan Landreth did not in fact make or implement any decision for Landreth Timber Company concerning construction, design, or redesign of the sawmill.

**RESPONSE:**

Deny.

64. By letter dated December 7, 1977 (Deposition Exhibit 290) Dennis communicated with Phil Cook concerning product mix policy and the potential advisability of purchasing a new kiln.

**RESPONSE:**

Admit.

65. Dennis sent copies of the letter which is Deposition Exhibit 290 to John Bolten, Jack Branch, Peter Townsend, Thomas Wood, and Frederick Fritz, but not to Ivan Landreth.

**RESPONSE:**

Admit.

66. By a second letter dated December 7, 1977 (Deposition Exhibit 291) Dennis communicated with Phil Cook concerning product pricing policy.

**RESPONSE:**

Admit.

67. Dennis sent copies of the letter which is Deposition Exhibit 291 to John Bolten, Jack Branch, Peter Townsend, Thomas Wood, and Frederick Fritz, but not to Ivan Landreth.

**RESPONSE:**

Admit.

68. By letter dated December 19, 1977 (Deposition Exhibit 294), Jack Branch advised Phil Cook of Ivan Landreth's post-closing role at the mill, stating, among other things:

"Ivan Landreth and his sons have sold 100% of the stock of Landreth Timber Company to B & D Corporation which subsequently will change its name back to Landreth Timber Company. Ivan Landreth has no stock whatsoever in the company and has been retained on an interim basis for perhaps one to three months as a consultant on matters relating to the transition in sales, contracts, customers, etc. In the event any of your personnel have any vague notions or concerns as to whether Ivan is still involved in the company, please be sure that he is not and although he is still around the mill, more or less tidying up his affairs, we will have no further use for his services in a short period of time . . . Should you have the need to show this letter to any interested party, please feel free to do so."

**RESPONSE:**

(see answer on attached sheet)

69. Jack Branch sent copies of the letter which is Deposition Exhibit 294 to Sam Dennis and John Bolten.

**RESPONSE:**

Admit.

70. Neither Sam Dennis nor John Bolten ever advised Ivan Landreth, Jack Branch, or Phil Cook that the characterization in Deposition Exhibit 294 of Ivan Landreth's role was inaccurate in any respect.

**RESPONSE:**

Deny.

71. Subsequent to closing, Ivan Landreth received no instructions from Dennis concerning Ivan Landreth's role as a consultant.

**RESPONSE:**

Deny.

72. After closing, Ivan Landreth was not allowed to sign checks in behalf of Landreth Timber Company.

**RESPONSE:**

Admit.



73. After closing, Ivan Landreth was not allowed the use of Landreth Timber company credit cards.

**RESPONSE:** Admit that defendant Landreth was not allowed the personal use of Landreth Timber Company credit cards. Admit that pursuant to consulting agreement, defendant Landreth was entitled to reimbursement for expenses.

**RESPONSE:**  
Admit.

74. After closing, Ivan Landreth's preclosing plans for construction of a timber kickout next to the Helle mill were not completed.

**RESPONSE:** Admit that plaintiff did not complete construction of a timber kickout next to the Helle mill, but deny that plaintiff did not intend to complete construction of the timber kickout.

75. After closing, Ivan Landreth's plans to build up slide guides on the mill's Nicholson 43-inch debarker were not completed.

**RESPONSE:** Admit that the Nicholson 43-inch debarker was completely replaced and building up slide guides on it was therefore not necessary.

76. After closing, Ivan Landreth's plan to install an automatic centering device on the 43-inch debarker was not completed.

**RESPONSE:** Admit that the Nicholson 43-inch debarker was completely replaced and installing a centering device was therefore unnecessary.

77. After closing, Ivan Landreth's plan to install a swing-cutoff saw on line in front of the 43-inch Nicholson debarker was not completed.

**RESPONSE:** Admit that the Nicholson 43-inch debarker was completely replaced and that installing a swing-cutoff saw on line in front of it was therefore unnecessary.

78. After closing, Ivan Landreth's plan to install a larger hydraulic tank on the Nicholson 43-inch debarker was not completed.

**RESPONSE:** Admit that the Nicholson 43-inch debarker was completely replaced and that installing a larger hydraulic tank on it was therefore unnecessary.

79. After closing, Ivan Landreth's plan to replace U-shaped Helle-mill wheels and rails with V-shaped wheels and rails was not completed.

**RESPONSE:** Admit that replacement of the U-shaped Helle mill wheels and rails was not completed, but deny that plaintiff did not intend to replace them with V-shaped wheels and rails.

80. After closing, Ivan Landreth's plan to install a conveyor to return boards from the resaw to the edger was not completed.

**RESPONSE:** Admit that the conveyor return from the resaw to the edger was not completed, but deny that plaintiff did not intend to complete it.

81. After closing, plaintiff and/or Phil Cook decided to remove the Filer & Stowell edger which was on site at the time of closing.

**RESPONSE:**  
Admit.

82. Ivan Landreth was not asked by plaintiff or Phil Cook to approve or disapprove of the decision to remove the Filer & Stowell edger.

**RESPONSE:**  
Deny.

83. After closing, plaintiff and/or Phil Cook decided to replace the Filer & Stowell edger with a used Klamath Ward Mark 50 edger.

**RESPONSE:**  
Admit.

84. Ivan Landreth was not asked by plaintiff or Phil Cook to approve or disapprove of the decision to purchase the Klamath Ward Mark 50 edger.

**RESPONSE:**  
Deny.

85. On December 28, 1977, Phil Cook purchased a 26 inch debarker for installation at the mill.

**RESPONSE:**

Admit.

86. Ivan Landreth was not asked by plaintiff or Phil Cook to approve or disapprove of the decision to purchase the second debarker.

**RESPONSE:**

Deny.

87. Ivan Landreth was entirely absent from the mill from December 22, 1977 to January 10, 1978.

**RESPONSE:** Plaintiff does not know the exact dates that defendant Landreth was absent from the facility. Plaintiff admits that defendant Landreth was absent from the facility for approximately fifteen to twenty days in late December 1977 and early January 1978.

88. After closing, Ivan Landreth did not retain control over the essential managerial efforts and decisions upon which the failure or success of Landreth Timber Company rested.

**RESPONSE:**

Deny.

89. After closing, control over the essential managerial efforts and decisions affecting the failure or success of the Landreth Timber Company rested with the new officers, directors, shareholders, and General Manager of the company.

**RESPONSE:**

Deny.

90. By letter dated January 10, 1978 Jack Branch notified Ivan Landreth that his employment as a consultant was being terminated.

**RESPONSE:**

Admit.

91. After termination, Ivan Landreth received no compensation of any kind, other than wages up to the date of termination and 30 days severance pay, from Landreth Timber Company.

**RESPONSE:**

Admit.

92. Subsequent to January 10, 1978, Ivan Landreth did not participate in any way in the management or operation of Landreth Timber Company.

**RESPONSE:**

Deny.

93. Between November 17, 1977, and January 10, 1978, Ivan Landreth had no communications with Dennis in any way relating to the management, operation or control of Landreth Timber Company.

**RESPONSE:**

Deny.

94. Between November 17, 1977 and January 10, 1978, Ivan Landreth had no communications with Jack P. Branch in any way relating to the management, operation or control of Landreth Timber Company.

**RESPONSE:**

Deny.

95. Between November 17, 1977, and January 10, 1978, Ivan Landreth had not communications with any officer or director of Landreth Timber Company

**RESPONSE:**

Deny.

Dated this 20th day of March, 1981.

BOGLE & GATES

/s/ James S. Smith, Jr.

James A. Smith, Jr.

Guy P. Michelson

Patricia H. Char

Richard D. Vogt

Attorneys for Defendants

Responses to the foregoing Requests for Admissions of Fact submitted this 26th day of March, 1981.

EDWARDS &amp; BARBIERI

/s/ Malcolm Edwards

Malcolm Edwards

John W. Hathaway

Attorneys for Plaintiff

CONTINUATION OF ANSWERS TO REQUESTS  
FOR ADMISSIONS

4. stock in Landreth Timber Company to a corporation to be formed by purchasers and that Dennis executed the stock purchase agreement as an accommodation buyer on behalf of the corporation to be formed.
6. Admit that B & D Company was substituted for Dennis as buyer under the stock purchase agreement as stated in paragraph 2 of the Assignment of, and Amendment to, stock purchase agreement and as contemplated by paragraph 3 of the stock purchase agreement.
7. Deny that Dennis was solely responsible for formation of B & D Company. Admit that B & D Company was a corporation formed by the purchasing group, solely for federal tax reasons, to purchase defendant's stock.
9. Deny that the merger of Landreth Timber Company into B & D Company was effected solely at Dennis' direction. Admit that the merger of Landreth Timber Company, Inc. and B & D Company was effected for the benefit of all shareholders of B & D Company in order to establish purchaser's property tax basis in assets of Landreth Timber Company.
21. Admit that, after closing, defendants had no stock right that would have entitled them to dividends or any share in the profits or losses of the corporation. Deny that defendants had no interest in, or obligations concerning, the profits and losses of the Landreth Timber Company.
29. Admit that defendant Landreth provided Jack Branch with the name of a person to be considered for the general manager position. Admit that this person was not Phil Cook. Deny that defendant Landreth recommended that purchasers hire this person.
30. Admit that purchasers, not Ivan Landreth, decided to retain Phil Cook as general manager and that Ivan Landreth was

not part of this decision. Deny that defendant Landreth was not asked to participate and cooperate in the search for a general manager and deny that defendant Landreth did not participate in this search.

39. Deny that Branch had any duty or function as a corporate officer to oversee construction progress and operations at the mill. Admit that Branch did visit the mill periodically after closing and that he did communicate his observations to Dennis and Bolten.
40. Deny that Branch had any official corporate oversight function. Admit that Branch's November 21, 1977 letter contained the quote stated. From information known or readily available to plaintiff, plaintiff cannot admit or deny the veracity of the quote.
55. Deny that Cook was not required to confer with defendant Landreth concerning decisions on product mix, product sales, and sale terms. Admit that, after conferring with defendant Landreth, Cook was authorized to make these decisions on behalf of plaintiff.
68. Admit that Branch made these statements in the December 19, 1977 letter to Phil Cook. Deny that these statements constituted advice to Cook concerning defendant Landreth's post-closing role at the mill and deny that these statements accurately describe defendant Landreth's post-closing role at the mill.

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No. 83-1961

Office - Supreme Court, U.S.

FILED

DEC 28 1984

ALEXANDER L. STEVAS.  
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**In the Supreme Court of the United States**

OCTOBER TERM, 1984

LANDRETH TIMBER COMPANY, PETITIONER

v.

IVAN K. LANDRETH, ET AL., RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE  
COMMISSION AS AMICUS CURIAE  
SUPPORTING PETITIONER

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### **QUESTION PRESENTED**

Whether the sale of all of the stock in a company is a securities transaction subject to the antifraud provisions of the federal securities laws.

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# In the Supreme Court of the United States

OCTOBER TERM, 1984

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No. 83-1961

LANDRETH TIMBER COMPANY, PETITIONER

*v.*

IVAN K. LANDRETH, ET AL., RESPONDENTS

---

ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE NINTH CIRCUIT

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BRIEF FOR THE SECURITIES AND EXCHANGE  
COMMISSION AS AMICUS CURIAE  
SUPPORTING PETITIONER

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## INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission, the agency principally responsible for the administration and enforcement of the federal securities laws, submits this brief as *amicus curiae* to address the question whether the sale of a controlling stock interest in a corporation is a “securities” transaction subject to the antifraud provisions of the federal securities laws. The court below held that a purchaser of a 100% stock interest is not entitled to the protections of those provisions. This ruling conflicts with decisions of the Courts of Appeals for the Second, Third,

Fourth, and Fifth Circuits.<sup>1</sup> Three other circuits adhere to versions of the "sale of business" doctrine endorsed by the court below.<sup>2</sup> Some lower courts have expanded this doctrine so far as to deny antifraud protections to purchasers of a 50% or less stock interest where the purchaser was found to have a role in corporate management.<sup>3</sup> The Court will hear a companion case, *Gould v. Ruefenacht*, cert. granted, No. 84-165 (Nov. 13, 1984), that presents the question whether the sale of a 50% stock interest is covered by the antifraud provisions of the federal securities laws.

The Commission disagrees with both the analysis employed and the result reached by the court below in this case and by other courts that have adopted the sale of business doctrine. Persons who bargain to

<sup>1</sup> *Ruefenacht v. O'Halloran*, 737 F.2d 320 (3d Cir. 1984), cert. granted *sub nom. Gould v. Ruefenacht*, No. 84-165 (Nov. 13, 1984); *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983); *Golden v. Garafalo*, 678 F.2d 1139 (2d Cir. 1982); *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir.), cert. denied, 444 U.S. 868 (1979); see also *Cole v. PPG Industries, Inc.*, 680 F.2d 549 (8th Cir. 1982) (interpreting Arkansas law by reference to federal securities law).

<sup>2</sup> *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982); *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982); *Chandler v. Kew, Inc.*, 691 F.2d 443 (10th Cir. 1977).

<sup>3</sup> See, e.g., *Ruefenacht v. O'Halloran*, Civ. No. 80-1097 (D.N.J. Apr. 15, 1983) (50% stock interest), rev'd, 737 F.2d 320 (3d Cir.), cert. granted *sub nom. Gould v. Ruefenacht*, No. 84-165 (Nov. 13, 1984); *Colson v. Bertsch*, 586 F. Supp. 1289 (D.N.J. 1984) (35%-49% stock interest); *Cadiz v. Jiminez*, 579 F. Supp. 1176 (D.P.R. 1983) (14% stock interest); *Oakhill Cemetery v. Tri-State Bank*, 513 F. Supp. 885 (N.D. Ill. 1981) (50% stock interest not a security if combined with corporate control).

purchase what is unquestionably stock should have the protection that investors reasonably expect to be associated with stock. In addition, adoption of the analysis underlying the sale of business doctrine could adversely affect protection for those who purchase instruments other than stock, such as notes and debt instruments. The resolution of the sale of business issue will not only affect private litigation but could also significantly affect enforcement actions brought by the Commission.

### STATEMENT

This action arises out of the sale by respondents Ivan K. Landreth and his sons of all of the outstanding common stock of a timber company. Petitioner Landreth Timber Company, the successor to the corporation formed to acquire the common stock from the Landreth family, was owned by a small investor group, including Samuel Dennis, a Boston attorney; his client John Bolten, a retired businessman who lived in Florida; and several others (Pet. App. 2a).<sup>4</sup> Petitioner brought this action against the sellers seeking damages under the antifraud provisions of the federal securities laws.<sup>5</sup> Petitioner alleged that, in

<sup>4</sup> Samuel Dennis originally executed the sale agreement. Before the closing on November 17, 1977, Dennis and the sellers agreed to assign the rights under the agreement to B & D Company, a corporation formed to complete the purchase (Pet. App. 2a). B & D merged with the timber company to form Landreth Timber Company (*ibid.*).

<sup>5</sup> The complaint sought relief under Sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. 77l(2) and 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), which are antifraud provisions. The complaint also sought relief for violations of registration requirements under Sections 5 and 12(1) of the Securities



connection with the sale, respondents had misrepresented or had omitted to state material facts concerning the liabilities of the timber company and the condition, production capacity, and completion cost of its principal asset, a partially-built sawmill (Second Amended Complaint ¶¶ 9-13, 24-25).

The district court granted respondents' motion for summary judgment, ruling that the transaction did not involve securities within the meaning of the federal securities laws. The district court acknowledged that the stock at issue possessed the characteristics of conventional "stock" (Pet. App. 13a), a term included in the statutory definition of a "security." Nevertheless, the court held that the stock could not be a security unless it met the test set forth in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), for identifying "investment contracts," another term included in the statutory definition of security. In the district court's view, this conclusion is mandated by *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975). Because the *Howey* test requires that anticipated profits be derived from the efforts of others, the court ordered the parties to submit facts bearing on managerial control. After reviewing the post-sale roles of the sellers and purchasers, the court found that the management of the business had passed into the hands of the purchasers (Pet. App. 19a-20a). On this basis, the court held that the petitioner did not satisfy the investment contract test.

The court of appeals affirmed (Pet. App. 1a-10a). It reasoned (Pet. App. 7a) that it should look beyond the statutory language in this case because it had previously done so in construing "note," another term in

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Act, 15 U.S.C. 77e and 77f(1), breach of contract, common law fraud, and violations of various state statutes.

the statutory definition of security. In adopting the sale of business doctrine, the court stated (Pet. App. 8a): "[W]hen a person purchases control of a business, he does not make an investment from which he expects profits solely from the efforts of others. Although the transaction involves stock, the economic realities reflect acquisition of a business, not passive investment, and the [securities] Acts therefore do not apply." Thus, like the district court, the court of appeals held that an instrument that was undeniably common stock was not a security unless it satisfied the investment contract test set forth in *Howey*.

## SUMMARY OF ARGUMENT

### I.

The plain language of the federal securities laws, the structure of those statutes, and their legislative history, all support the conclusion that petitioner's purchase of ordinary common stock was a securities transaction. With respect to the status under the securities laws of ordinary common stock, the statutory language is clear—the term "stock" is expressly included in the statutory definition of "security." Excluding conventional common stock from the coverage of the securities laws because it does not also meet the test for an "investment contract," another specifically enumerated term in the statutory definition of security, violates established canons of statutory construction. In addition, the structure of the federal securities laws refutes respondents' suggestion that the sale of business doctrine should be adopted because those laws are not concerned with private transactions or transactions involving transfer of control; numerous provisions in those laws are

concerned with such matters. Furthermore, nothing in the legislative history of the securities laws supports respondents' position that the sale of a controlling stock interest should be construed to be outside the express coverage of those laws. Instead, the legislative history supports a broad reading of "security."

## II.

This Court's decision in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), warrants no departure from the plain meaning of the statute. *Forman* did not hold that the investment contract test must be applied to all types of securities, including ordinary corporate stock; rather, *Forman* held that so-called "stock" entitling the purchaser to lease an apartment was not a security. In reaching its decision, the Court utilized the investment contract test only after concluding that the "stock" at issue in that case did not come within the statutory term "stock" because it did not possess the characteristics typically associated with that type of instrument. In contrast to *Forman*, the instruments in the present case possess all of the characteristics of conventional stock.

Nor does this Court's decision in *Marine Bank v. Weaver*, 455 U.S. 551 (1982), support adoption of the sale of business doctrine. The Court in *Weaver* relied on the prefatory clause to the statutory definitions, "unless the context otherwise requires," to hold that, in light of the comprehensive scheme under which federally regulated and insured banks conduct business, certificates of deposit of such banks should not be deemed securities for purposes of the antifraud provisions of the federal securities laws. There is no comparable alternative federal comprehensive regulatory scheme here.

## III.

Important policy considerations counsel rejection of the sale of business doctrine. Application of that doctrine would require an inquiry into the nebulous area of corporate control and would create arbitrary distinctions among transactions and among their participants. The only certain result of adopting the doctrine would be an increased burden on the federal courts and on litigants. In addition, purchasers of conventional stock should not be excluded from the protections of the securities laws simply because they intend to play a role in the operation of the business. The possibility of fraud is not eliminated because the purchaser acquires a controlling stock interest. Furthermore, the alleged fraud in this case related to the condition of the corporation and value of the stock at the time of its purchase. At that time petition was no less a passive investor than one who buys shares in the market. Finally, contrary to respondents' argument, a stock sale is not the same as an asset sale; the risks and consequences of the two types of transactions are substantially different.

## ARGUMENT

### I. IN VIEW OF THE PLAIN LANGUAGE, THE STRUCTURE, AND THE LEGISLATIVE HISTORY OF THE FEDERAL SECURITIES LAWS, PETITIONER'S PURCHASE OF CONVENTIONAL COMMON STOCK WAS A SECURITIES TRANSACTION

A. "The starting point in every case involving construction of a statute is the language itself." *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558 (1979), quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring). With respect to the status under the



federal securities laws of ordinary common stock, the statutory language could not be more clear. The term "security" is defined in both the Securities Act of 1933 and the Securities Exchange Act of 1934 to include "stock."<sup>6</sup> Although not defined in the Acts, "stock" carries a well-defined meaning. *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943). See *Ballentine's Law Dictionary* 1236 (2d ed. 1930): "As the term is used in connection with corporations, it means the capital of the corporation \* \* \*." By its nature, stock represents both ownership and control, conferring the right "to participate in the general management of the company." *Black's Law Dictionary* 1660 (3d ed. 1933). The district court concluded in this case that the timber company's stock "possessed the ordinary characteristics of stock" (Pet. App. 13a), and it is not disputed that the instruments purchased by petitioner were conventional common stock.

"Investment contract" is also specifically enumerated in the statutory definition of security. See note

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<sup>6</sup> Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10), provides:

The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement, \* \* \* investment contract, voting-trust certificate, \* \* \* or in general, any instrument commonly known as a "security" \* \* \*.

Section 2(1) of the Securities Act, 15 U.S.C. 77b(1), is virtually identical. *Marine Bank v. Weaver*, 455 U.S. 551, 555 n.3 (1982). All 40 definitions in the 1934 Act, 15 U.S.C. 78c(a), and all 15 definitions in the 1933 Act, 15 U.S.C. 77b, are preceded by the statutory language "When used in this [chapter], unless the context otherwise requires \* \* \*." See pages 19-21, *infra*.

6, *supra*. Unlike "stock," "investment contract" is a general term designed to ensure that novel, unconventional, or irregular instruments that might not be considered securities in normal parlance are covered by the securities laws. See *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-299 (1946); *C.M. Joiner Leasing Corp.*, 320 U.S. at 351. Thus, by including the term "investment contract" in the definition of "security," Congress broadened the definition to include more than ordinary stocks and bonds.

The court of appeals held that the purchase of stock by petitioner was not a securities transaction because it did not satisfy the test set forth in *SEC v. W.J. Howey Co.*, *supra*, for determining whether a novel instrument is an investment contract: that it "involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U.S. at 301 (see Pet. App. 8a). But invoking the investment contract test to determine the status under the securities laws of stock—a separate term in the definition of security—violates established canons of statutory construction.

A statute should be construed "to give effect, if possible, to every clause and word of a statute." *United States v. Menasche*, 348 U.S. 528, 538-539 (1955), quoting *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1882). See also 2A N. Singer, *Statutes and Statutory Construction* § 46.06 (4th rev. ed. 1984). Indeed, "[t]here was little reason for the drafters to use words such as 'stock,' 'treasury stock,' or 'voting-trust certificate,' unless their intention was to include all such instruments as commonly defined." *Golden v. Garafalo*, 678 F.2d at 1144. It is apparent from the statutory language that investment contracts are properly viewed as only one of "the several types of



instruments designated as securities" under the definitional sections of the securities laws. *Tcherepnin v. Knight*, 389 U.S. 332, 338 (1967). Once the court concluded that the instruments purchased by petitioner were ordinary common stock, it should have ended its inquiry and held that those instruments were securities.<sup>7</sup>

The court of appeals reasoned (Pet. App. 7a-9a) that it should use a transactional analysis in construing "stock" because it had previously used such an analysis in defining "note," another term in the statutory definitions of security.<sup>8</sup> But "note" and "stock" are very different sorts of terms. "Note" is a vague

<sup>7</sup> This Court first interpreted the meaning of security in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943). That case made clear that Congress did not intend the more general terms in the Securities Act definition of "security," such as "investment contract," to be construed narrowly on account of the more specific terms, such as "stock" and "bond." Instead, the Court held that the term "investment contract" broadens the definition of "security" to include instruments other than traditional stocks and bonds. The conclusion of the court below that the general phrase "investment contract" circumscribes the scope of "stock", a specific term, "turn[s] the history of the Acts \* \* \* on their heads." *Ruefenacht v. O'Halloran*, 737 F.2d at 329.

<sup>8</sup> The Ninth Circuit uses a "risk capital" test to determine whether a note is a security. *Great Western Bank & Trust Co. v. Kotz*, 532 F.2d 1252, 1257-1258 (1976). Most other courts of appeals have adopted the "commercial-investment dichotomy" in determining whether notes are securities. See, e.g., *Bellah v. First National Bank*, 495 F.2d 1109, 1111-1114 (5th Cir. 1974). The Second Circuit has taken a slightly different approach. It begins with a presumption that the statute encompasses any note, but excludes notes bearing a "family resemblance" to consumer or commercial transactions. See *Exchange National Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1137-1138 (1976).

term meaning nothing more than a promise to pay money. *In re Cochise College Park, Inc.*, 703 F.2d 1339, 1347 (9th Cir. 1983). It includes investment instruments as well as commercial loan transactions and consumer payment plans.<sup>9</sup> Accordingly, courts have found it necessary to look at various factors relating to the transaction at issue, rather than just to the instrument itself, to determine whether a particular note is covered by the securities laws. See, e.g., *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1361-1362 (7th Cir.), cert. denied, 423 U.S. 825 (1975); *McClure v. First National Bank*, 497 F.2d 490, 494 (5th Cir. 1974), cert. denied, 420 U.S. 930 (1975). "Stock," in contrast, is a precise term denoting an easily recognizable, conventional instrument with common characteristics. Thus, in the case of ordinary stock, analysis of the transaction at issue is not required. See *Ruefenacht v. O'Halloran*, 737 F.2d at 325. If an instrument is ordinary stock, which has a traditional and accepted meaning and which "represents to many people, both trained and untrained in business matters, the paradigm of a security" (*Daily v. Morgan*, 701 F.2d at 500), it is not necessary to look beyond the instrument to determine whether it is a security.<sup>10</sup>

<sup>9</sup> See, e.g., *Hunssinger v. Rockford Business Credit, Inc.*, 745 F.2d 484 (7th Cir. 1984); *Zabriskie v. Lewis*, 507 F.2d 546 (10th Cir. 1974); *Bellah v. First National Bank*, 495 F.2d 1109 (5th Cir. 1974).

<sup>10</sup> As Professor Loss has stated in criticizing the sale of business doctrine: "It is one thing to say [as was held in *Forman*] that the typical cooperative apartment dweller has bought a home, not a security \* \* \*. But stock (except for the residential wrinkle) is so quintessentially a security as to foreclose further analysis." L. Loss, *Fundamentals of Securities Regulation* 212 (1983) (emphasis in original).

B. The statutory scheme of the federal securities laws supports rejection of the sale of business doctrine. Contrary to the suggestion of respondents (Br. in Opp. 3, 6), the antifraud provisions of the securities laws apply to private, negotiated transactions.<sup>11</sup> While transactions not involving a public offering are exempt from the registration requirements (see Section 4(2) of the Securities Act, 15 U.S.C. 77d(2)), there is no comparable exemption from antifraud liability.<sup>12</sup> "Thus, the coverage of the antifraud provisions of the securities laws is not limited to instruments traded at securities exchanges and over-the-counter markets \* \* \*." *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982). These provisions have "always been understood to apply to transactions in shares of close as well as publicly held corporations and to negotiated as well as market sales and purchases of shares." *Golden v. Garafalo*, 678 F.2d at 1146-1147 (citing *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971)).<sup>13</sup>

<sup>11</sup> Professor Loss has characterized that doctrine as coming "dangerously close to the heresy of saying that the fraud provisions do not apply to private transactions." L. Loss, *supra*, at 212; see note 10, *supra*.

<sup>12</sup> The Fifth Circuit in *Daily v. Morgan* emphasized (701 F.2d at 502):

If Congress had wanted to exempt the privately negotiated sale of a controlling interest of stock in a small business from [the] antifraud provision [of Section 10(b)] it could have done so. \* \* \* Congress could and did exempt small, private sales of stock from many of the requirements of the securities laws, but chose to apply the section 10(b) antifraud provision to all stock.

<sup>13</sup> The analysis of this Court in *Weaver*, in holding that a negotiated loan agreement was not a security, does not suggest a contrary conclusion. In reaching the determination

Nor do the securities laws exclude transactions affecting the transfer of controlling stock interests, as respondents suggest (Br. in Opp. 8). On the contrary, the Securities Exchange Act contains provisions specifically covering tender offers, disclosure of transactions by corporate directors, officers, and principal stockholders, and the recovery of short-swing profits garnered by such persons. See, *e.g.*, Sections 14 and 16 of the Securities Exchange Act of 1934, 15 U.S.C. 78n, 78p. See also *Daily v. Morgan*, 701 F.2d at 503 ("a rule that turns on the transfer of control would logically exclude from the reach of Rule 10b-5 many tender offer battles"). Thus, the securities laws themselves refute the notion that those laws were intended only to cover passive investors purchasing minority interests.

C. The legislative history provides no justification for the sale of business doctrine. Rather, it supports a broad reading of the term "security." Congress did not specifically address the sale of business issue, but

that a unique agreement between two families, which included arrangements for the use of a barn and pasture, was not a security, that opinion distinguished "those instruments ordinarily and commonly considered to be securities in the commercial world"—which the securities laws were plainly intended to cover—from "unusual instruments," such as the investment contracts at issue in *Howey*. 455 U.S. at 559. As this Court in *Weaver* explained, "[t]he *unusual* instruments found to constitute securities in prior cases involved offers to a number of potential investors, not a private transaction \* \* \*[,] had equivalent values to most people and could have been traded publicly." *Id.* at 559-560 (emphasis added). Thus, while the Court recognized (*id.* at 559-560 & n.11) that novel instruments are properly subject to transactional analysis in order to determine whether they are investment contracts, it did not suggest such an analysis for stock or other conventional instruments.



the House Report accompanying what became the Securities Act explains that the term "security" was intended to cover the "many types of instruments that in our commercial world fall within the ordinary concept of a security." H.R. Rep. 85, 73d Cong., 1st Sess. 11 (1933). This statement supports "the proposition that instruments ordinarily regarded as 'stock' are a 'security', notwithstanding that the underlying transaction involves a transfer of control. This understanding of Congressional intent, moreover, has been almost universally accepted by the courts, the relevant agency and the bar for over 40 years." *Golden v. Garafalo*, 678 F.2d at 1144-1145.<sup>14</sup> In the face of legislative silence as to the precise issue presented here, courts should assume "that the legislative purpose is expressed by the ordinary meaning of the words used." *Securities Industry Ass'n v. Board of Governors of the Federal Reserve System*, No. 82-1766 (June 28, 1984), slip op. 11 (quoting *Russello v. United States*, No. 82-472 (Nov. 1, 1983), slip op. 4; *Richards v. United States*, 369 U.S. 1, 9 (1962)).<sup>15</sup>

<sup>14</sup> This Court has recognized that investor protection is not the sole purpose of the securities laws. See *United States v. Naftalin*, 441 U.S. 768, 776 (1979) (quoting S. Rep. 42, 73d Cong., 1st Sess. 1 (1933); 77 Cong. Rec. 2925 (1933) (remarks of Rep. Kelly); *id.* at 2935 (remarks of Rep. Chapman) (acknowledging congressional concern with protecting "honest corporate business" and "ethical business men").

<sup>15</sup> This Court recently rejected an argument similar to respondents' in *Securities Industry Ass'n v. Board of Governors of the Federal Reserve System*, No. 82-1766 (June 28, 1984). In construing the Banking Act of 1933 (the Glass-Steagall Act), enacted by Congress only weeks after the Securities Act, this Court held that the terms "notes or other securities" which appear in Section 21(a)(1) of that Act, 12 U.S.C. 378(a)(1), together with the terms "stocks" and

## II. PRIOR HOLDINGS OF THIS COURT SUPPORT THE CONCLUSION THAT PETITIONER'S PURCHASE OF COMMON STOCK WAS A SECURITIES TRANSACTION

A. This Court's decision in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), warrants no departure from the plain language of the statute. *Forman* did not hold, as respondents (Br. in Opp. 9) claim, that the investment contract test formulated in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), is the sine qua non for all securities, including ordinary stock in a business corporation. Nor did that case establish a single "economic reality" test (Pet. App. 7a-8a). Indeed, the two-part analysis that the Court used in *Forman* bolsters the conclusion that the investment contract test is not applicable to instruments that come within one of the specific statutory terms in the definition of security. *Ruefenacht v. O'Halloran*, 737 F.2d at 338.

The plaintiffs in *Forman* purchased shares of "stock" in a cooperative housing corporation entitling them to apartments in a state-subsidized and supervised non-profit housing cooperative. They acquired this "stock" solely to obtain a place to live, the number of shares being proportionate to the number of rooms in the apartment. The "stock" lacked the characteristics of ordinary stock. It paid no dividends and could not be pledged, encumbered, or transferred

"bonds," should not be narrowed to include only instruments that share characteristics "of an investment" common to the other named instruments. *Securities Industry Ass'n*, slip op. 11-16. Such a restrictive reading, this Court pointed out, is not indicated by the phrasing of the statutory sections, is inconsistent with the broad statutory scheme, and is not supported by the legislative history. *Ibid.* Each of these conclusions is equally applicable and compelling here.



to a non-tenant. Each apartment owner was entitled to one vote, regardless of the number of shares held. Any tenant terminating his occupancy was required to resell the "stock" to the issuer at the initial selling price or, under certain circumstances, to sell to a qualifying replacement tenant at virtually the same price. 421 U.S. at 842-843, 851.

In ruling that the so-called "stock" interests were not "securities," the Court engaged in a two-step analysis: it first considered whether they were securities by virtue of coming within the definitional term "stock"; and, then, alternatively, the Court considered whether they were securities by virtue of coming within a more general definitional term, such as "investment contract." With respect to the first question, this Court recognized that an instrument should not be deemed to be a security simply because someone chose to call it "stock." The Court explicitly acknowledged, however, that the name given an instrument may be highly pertinent (421 U.S. at 850-851):

In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

The *Forman* Court concluded that the purchasers in that case were not misled by the word "stock" because the shares they had bought bore none of the indicia typically associated with stock. In so holding,

the Court identified five characteristics of stock: (1) the right to receive dividends contingent upon an apportionment of profits; (2) negotiability; (3) the ability to be used as collateral; (4) voting rights in proportion to the number of shares owned; and (5) share appreciation. *Id.* at 851. Judged by such criteria, the cooperative shares were not instruments "that in our commercial world fall within the ordinary concept of a security" (*ibid.*; quoting H.R. Rep. 85, 73d Cong., 1st Sess. 11 (1933)). Thus, the Court held that, as a matter of economic reality, the plaintiffs in *Forman* had not purchased stock within the meaning of the securities laws.

The Court then examined the instrument to determine whether it nonetheless constituted a security by coming within one of the more general terms that also appear in the statutory definition, including "investment contract" and "an instrument commonly known as a 'security'." 421 U.S. at 851-858.<sup>16</sup> Applying the *Howey* test, the Court concluded that because the purchasers of the cooperative housing corporation shares wanted only to acquire living quarters for personal use, not to make an investment in the hope of

<sup>16</sup> In *Forman*, the Court stated that the investment contract test applies to both terms. 421 U.S. at 852. ("We perceive no distinction for present purposes, between an 'investment contract' and an 'instrument commonly known as a 'security.''" \* \* \* The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."). The Court did not thereby imply that the same test would govern the more specific terms, such as "stock," "bond," or "debenture." But see *King v. Winkler*, 673 F.2d at 344-345 (construing the quoted language in *Forman* as mandating that test for conventional instruments such as stock).

receiving profits from the efforts of others, their "stock" was not an investment contract.<sup>17</sup>

In reaching that conclusion, the Court observed (421 U.S. at 852-853) that the *Howey* test "embodies the essential attributes that run through all of the Court's decisions defining a security." Contrary to respondents' contention (Br. in Opp. 9), the Court, in making that statement, was "merely describing its past decisions," all of which happened to deal with unusual or unconventional instruments. *Daily v. Morgan*, 701 F.2d at 499-500.<sup>18</sup> It was not referring to any decision construing the term "stock." The Court has not suggested that the *Howey* test should be "invoked ritualistically whenever the existence of a security is at issue." *Meason v. Bank of Miami*,

<sup>17</sup> The court of appeals had relied on the investment contract analysis as an alternative basis upon which to conclude that the "stock" involved in that case was a security. 421 U.S. at 846.

<sup>18</sup> See *Tcherepnin v. Knight*, *supra* (involving withdrawable capital shares of a savings and loan association); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) (involving combined variable and fixed annuity); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) (involving variable annuity contract); *SEC v. W.J. Howey Co.*, *supra* (involving sales of citrus acreage coupled with optional service contracts to cultivate the crops); *SEC v. C.M. Joiner Leasing Corp.*, *supra* (involving sales of assignments of oil leases).

*International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), which reiterated the *Forman* description of past decisions by the Court (439 U.S. at 558 n.11), likewise lends no support to the sale of business doctrine. That case dealt with a participation in a pension plan, an interest which, unlike stock, is not enumerated in the statutory definition. Since a pension interest could not be a security unless it came within a general term, it is hardly surprising that this Court discussed the interest under the rubric of investment contract.

652 F.2d 542, 549 (5th Cir. 1981), cert. denied, 455 U.S. 939 (1982). Rather, "the Court has applied the *Howey* test when considerations pertinent to an investment contract applied to the instrument in question" (*ibid.*).<sup>19</sup> Thus, in *Forman* this Court utilized that test only to determine whether the cooperative shares, which it had already concluded were not conventional stock, were nonetheless securities in the form of an investment contract. But, as stated in *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202, 1204 (4th Cir.), cert. denied, 444 U.S. 868 (1979), "[a]bsent some showing that ordinary corporate stocks are other than what they appear to be," application of the *Howey* test is inappropriate.

B. In urging an interpretation contrary to the statutory language and legislative history, respondents, citing *Marine Bank v. Weaver*, *supra*, point (Br. in Opp. 7-18, 12) to the clause "unless the context otherwise requires," which precedes the definitional sections.<sup>20</sup> In *Weaver*, the Court, relying on that

<sup>19</sup> Application of the investment contract test in all cases could result in decisions excluding many instruments commonly thought of as securities from the protection of the antifraud provisions of the securities laws because that test includes criteria that instruments specifically enumerated in the statutory definition may not meet. For example, some lower courts have suggested instruments paying a fixed interest do not meet the "profits" element of that test. *Briggs v. Sterner*, 529 F. Supp. 1155, 1168 (S.D. Iowa 1981). See generally, *Hunzinger v. Rockford Business Credits, Inc.*, 745 F.2d 484 (7th Cir. 1984) (if *Howey* applied to all instruments, many instruments assumed to be securities, including twenty year corporate bonds, would not be securities because they could not meet the definition of "profit").

<sup>20</sup> The Seventh Circuit in *Sutter v. Groen*, 687 F.2d at 200-201, also relied on *Weaver* to support the sale of business doctrine.



clause, held that, in the light of the comprehensive scheme under which federally regulated and insured banks conduct business, certificates of deposit of such banks are not securities for purposes of the antifraud provisions of the federal securities laws.<sup>21</sup> The Court concluded in *Weaver* that holders of such bank certificates of deposit are abundantly protected under the federal banking laws, and thus imposition of another federal statutory scheme would contravene Congressional intent. 455 U.S. at 558-559. No such contextual considerations are relevant here, because there is no alternative federal comprehensive regulatory scheme.<sup>22</sup>

As Judge Friendly emphasized in *Exchange National Bank v. Touche Ross & Co.*, 544 F.2d at 1137-

<sup>21</sup> The Securities and Exchange Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation filed a brief *amicus curiae* urging that position.

<sup>22</sup> Respondents suggest (Br. in Opp. 13) that the petitioner has an adequate remedy under state law. However, as the Third Circuit has observed:

The premise that common-law remedies are necessarily adequate in the sale-of-business context is flawed. The defendant, for example, may prove to be insolvent, prompting the plaintiff to seek out solvent defendants among those parties who may be sued by virtue of the absence of privity requirements under federal law. Congress, moreover, did not confine the protection of federal law to instances in which no adequate common-law remedy could be had. The Acts, for example, confer additional benefits on parties victimized by fraud, including the absence of express defenses and certain procedural advantages.

*Ruefenacht v. O'Halloran*, 737 F.2d at 336 (footnotes omitted).

1138 (emphasis in original), a party who relies on the "unless the context otherwise requires" language of the statutory definitions—when an instrument fits within their plain terms—to argue that the antifraud provisions are not applicable "has the burden of showing that 'the context otherwise requires.'"<sup>23</sup> *Weaver* involved an exceptional situation where the context did so require. Certainly, the context of the present case, in which petitioner's interest comes within the fundamental Congressional purpose of protecting purchasers and sellers of stock, does not justify a departure from the statutory language.

### III. IMPORTANT POLICY CONSIDERATIONS ALSO COUNSEL REJECTION OF THE SALE OF BUSINESS DOCTRINE

A. "The most prominent feature of the sale-of-business doctrine is its attendant uncertainty of application \* \* \*." *Ruefenacht v. O'Halloran*, 737 F.2d at 332. The inability of parties to a transaction to predict whether the securities laws are applicable "raises the cost of economic transactions, inhibits the flow of capital, spawns litigation, and in general benefits neither the parties nor the court." *Id.* at 333. A major source of uncertainty is the reliance by courts adopting the sale of business doctrine on whether the purchaser intends to manage or has "control" of the corporation (see Pet. App. 9a). This threshold inquiry is by no means simple. Purchasers

<sup>23</sup> The court added: "So long as the statutes remain as they have been for over forty years, courts had better not depart from their words without strong support for the conviction that, under the authority vested in them by the 'context' clause, they are doing what Congress wanted when they refuse to do what it said." 544 F.2d at 1138.



have varying degrees of intent to manage, and their intentions may not be fixed or may in any case change.<sup>24</sup> Likewise, determining who has control of a corporation can be an elusive inquiry.<sup>25</sup> "Wholly apart from the oddity of making what a security is depend upon these factors, they raise the prospect of a substantial hearing in many cases simply to determine whether an instrument is a 'security.'" *Ruefenacht v. O'Halloran*, 737 F.2d at 332 (emphasis in original).<sup>26</sup> "Without some clearer directive from

<sup>24</sup> As one court has explained:

If intent to manage [the acquired corporation] is relevant, adoption of the [sale of business] doctrine will lead to countless issues of mixed fact and law such as whether part-time managers are passive or active, what classification to accord controlling shareholders who intervene sporadically, and the status of new investors who assume ambiguous roles as employees or who intend initially to remain passive but are soon forced into management roles.

*Golden v. Garafalo*, 578 F.2d at 1145-1146.

<sup>25</sup> The Third Circuit addressed some of the problems in determining who has control:

Control may be exercised, for example, by alliances of minority shareholder factions. One indicator of whether a minority share effectively exercises control might be whether the purchase price of the share exceeded the prevailing market price. Another might be the voting patterns of various factions. . . . [T]estimony might be taken on the intent of the purchasers and the realities of corporate management.

*Ruefenacht v. O'Halloran*, 737 F.2d at 332.

<sup>26</sup> The Seventh Circuit, which requires such an inquiry in cases involving stock transfers, has fashioned a "main purpose" test, whereby a purchaser who has acquired more than 50% but less than 100% of a corporation's stock will be

Congress that it intended the statutory terms to involve the nebulous inquiry" required by the sale of business doctrine, there is no reason "to narrow the ordinary meaning of the statutory language." *Securities Industry Ass'n v. Board of Governors of the Federal Reserve System*, No. 82-1766 (June 28, 1984), slip op. 13-14.

The sale of business doctrine also creates arbitrary distinctions among transactions and among their participants. For example, in the event a single purchaser bought 100% of the shares of a corporation from an 80% seller and various minority holders, the doctrine could lead to the anomalous result that the minority sellers would be deemed to have engaged in securities transactions, while the purchaser and 80% seller would not. Compare *Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir.), cert. denied, 451 U.S. 1017 (1981) (holding that the purchaser of 100% of the stock in a company did not acquire securities), with *McGrath v. Zenith Radio Corp.*, 651 F.2d 458 (7th Cir.), cert. denied, 454 U.S. 835 (1981) (concluding that the selling shareholders on the other side of such a transaction *could* maintain an action for anti-fraud violations).<sup>27</sup> Such a variable standard "would

presumed to have made the acquisition for "entrepreneurship rather than investment," unless the purchaser can show that his "main purpose" was investment. *Sutter v. Groen*, 687 F.2d at 203. As described (pages 24-26, *infra*), there is no statutory or policy basis for drawing this distinction.

<sup>27</sup> By using terms such as "stock" and "bond," Congress drew on well-settled state-law definitions. See *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. at 351. The meaning of such terms was not dependent on who

owned the instrument at any particular moment, and did not admit of asymmetries between buyer and seller. . . . Fluctuations in the identity of the instrument were foreign to the notion of stock. The chameleon-like quality

be difficult to apply and [would] create a capricious basis for dispensing the protection" of the securities laws. *Occidental Life Insurance Co. v. Pat Ryan & Associates, Inc.*, 496 F.2d 1255, 1263 (4th Cir.), cert. denied, 419 U.S. 1023 (1974).<sup>28</sup>

B. There is no warrant for excluding purchasers of conventional stock from the protections of the securities laws on the notion that an entrepreneur is essentially different from an investor (see Pet. App. 7a). Investors often participate in management in order to protect their interest. *Ruefenacht v. O'Halloran*, 737 F.2d at 334. "Had Congress intended so fundamental a distinction, it would have expressed that intent clearly in the statutory language or the legislative history." *Securities Industry Ass'n*, slip op. 14-15 (quoting *American Tobacco Co. v. Patterson*, 456 U.S. 63, 72 n.6 (1982)). Nor does "telling a defrauded purchaser that he has no federal remedy because he is an 'entrepreneur' and not an 'investor'" appeal to any "abstract sense of fairness." *Daily v. Morgan*,

of stock under the sale-of-business doctrine is wholly arbitrary with respect to the state-law definitions that are the source of the terms in the 1933 and 1934 Acts.

*Ruefenacht v. O'Halloran*, 737 F.2d at 336.

<sup>28</sup> This Court's decision in *Marine Bank v. Weaver*, *supra*, lends no support to the notion that an instrument may or may not be a security depending on the circumstances of the particular transaction—i.e., that the same share of stock which is a security when it is sold today, may not be a security when it is resold tomorrow. As noted, *Weaver* focused on the federal regulatory scheme governing certificates of deposit issued by banks. The Court did not consider the transactional context in that case and, indeed, "reject[ed] respondents' argument that the certificate of deposit was somehow transformed into a security when it was pledged, even though it was not a security when purchased." 455 U.S. at 559 n.9.

701 F.2d at 503. Indeed, it has been suggested that a large purchaser may have a "more pressing need for protection to the extent that he has expended a greater amount of his resources." *Occidental Life Insurance Co. v. Pat Ryan & Associates, Inc.*, 496 F.2d at 1263.

The fact that the petitioner may not be a "passive" (Pet. App. 8a) or unsophisticated investor is no reason to foreclose it from bringing suit under the antifraud provisions of the securities laws (see Resp. Br. in Opp. 3, 4). Those protections are not limited to the unsophisticated.<sup>29</sup> The possibility of fraud, as alleged here, is not eliminated because the purchaser acquires a controlling stock interest. As demonstrated by recent history, management of even closely regulated companies can deceive their auditors and regulators. See *e.g.*, *Dirks v. SEC*, 463 U.S. 646 (1983) (describing the fraud practiced by Equity Funding Corporation of America).<sup>30</sup>

<sup>29</sup> The Second Circuit pointed out in a case involving a Chicago bank and a New York Stock Exchange member brokerage firm, *Exchange National Bank v. Touche Ross & Co.*, 544 F.2d at 1137: "While banks are in a favored position to obtain disclosure, the target of §§ 10(b) of the 1934 Act and 17(a) of the 1933 Act is fraud, which a bank's ability to obtain disclosure cannot always prevent."

<sup>30</sup> "One of Congress' purposes in singling out the named instruments in the Act was to facilitate [non-market] transactions [in those instruments] without the ensuing delays, duplication of effort, and expenses associated with the 'caveat-stockholder' era of deregulation." *Ruefenacht v. O'Halloran*, 737 F.2d at 333 (citing H.R. Rep. 1383, 73d Cong., 2d Sess. 4-5 (1934)). The sale of business doctrine represents a return to that era. It may be true that in the absence of statutory protection against material misrepresentations, certain purchasers would be able to hire a team of accountants and attorneys to uncover adroitly hidden liabilities or other



Like any securities investor, the petitioner and its investor group were concerned with the value of the stock they were acquiring, and were seeking to make a profit which would be reflected in the price of those shares. The extent of petitioner's present ownership interest and of its present power to affect policies of the corporation provides no basis for denying it protection under the federal securities laws. The alleged fraud occurred in connection with the purchase, and related to the condition and circumstances of the corporation and the value of the stock at the time of purchase. Petitioner was then no less a passive investor than a person who buys shares in the market.

C. Finally, contrary to the view of the court below (see Pet. App. 8a), the difference between a sale of a majority or 100% stock interest and a sale of assets is not merely one of form: "Generally speaking, one who purchases the assets of a business is not liable for its debts and liabilities, while one who purchases the stock in a corporation—a separate legal entity—assumes ownership of a business with both assets and liabilities." *Daily v. Morgan*, 701 F.2d at 504 (citations omitted). Thus, buyers of business enterprises may very well wish to consider, in the mix of tax, personal liability, and other factors bearing on whether the transaction should be structured as a transfer of stock or assets, the need for antifraud protection. Since "[l]iabilities \* \* \* are often the subject of inaccurate or incomplete disclosures" (*ibid.*), antifraud protection may be particularly important in the context of a stock sale. Here, the parties chose to structure their deal, not as a sale of

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concealed facts. However, such an inquiry would be both costly and inefficient.

assets, but as a stock sale.<sup>31</sup> Under these circumstances, respondents, who are accused of fraudulently misrepresenting the timber company's liabilities, are in a poor position to challenge the expectation that the antifraud provisions would apply. See *Daily v. Morgan*, 701 F.2d at 503.

### CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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DECEMBER 1984

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<sup>31</sup> An assumption by petitioner that the antifraud provisions would apply to this sale would have been reasonable where, as here, the stock purchased has all the traditional attributes commonly associated with stock ownership. *United Housing Foundation, Inc. v. Forman*, 421 U.S. at 850-851.



6  
No. 83-1961

Supreme Court, U.S.  
FILED  
JAN 11 1985

ALEXANDER L. STEVENS  
CLERK

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1984

LANDRETH TIMBER COMPANY,  
*Petitioner,*  
v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
AND KATHLEEN LANDRETH,  
*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Ninth Circuit

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UNITED STATES DISTRICT COURT  
FOR THE WESTERN DISTRICT OF WASHINGTON

Docket No. C78-663R

IVAN K. LANDRETH and JANE DOE LANDRETH, husband  
and wife; THOMAS E. LANDRETH and MARY DOE LAN-  
DRETH, Husband and wife; IVAN K. LANDRETH, JR. and  
SARA DOE LANDRETH, husband and wife,  
*Deft-third party pltf.*

vs.

LANDRETH TIMBER COMPANY, INC.,  
*Third party deft.*

RELEVANT DOCKET ENTRIES

DATE	NR.	PROCEEDINGS
1978		
Nov 1	1	Filed complaint & issued 20 days summons
Nov 15	2	Filed notice of appearance for defts, Mr. James A. Smith, Jr., Attorney.
Nov 20	3	Filed marshal's return on s/c of Kvan (sic) K. Landreth.
Nov 28	4	Filed & Ent. stipulation for extension of time to answer to December 18, 1978. Mailed copies.
Dec 15	5	Filed pltfs first amended complaint and jury demand.
Dec 26	6	Filed answer affirmative defenses, and coun- terclaims of defts Ivan K. Landreth and Lucille Landreth, Husband and wife; Thomas E. Landreth; Ivan K. Landreth, Jr., and Kath- leen Landreth, Husband and wife, Jury de- mand.



DATE	NR.	PROCEEDINGS
1979		
Jan 15	7	Filed Third party pltf-Landreth Timber Co., Inc., reply to defts Counterclaims.
Jan 25		Lodged stipulation and order extending time to answer interrogatories and produce documents.
Jan 29	8	Filed & Ent. stipulation and order extending time to answer interrogatories and produce documents to and including February 26, 1979. Mailed copies.
Feb 27		Lodged stipulation and order extending time to answer interrogatories and produce documents.
Feb 28	9	Filed & Ent. order (Stipulated) for extending time to answer interrogatories and produce documents to Tuesday, March 13, 1979. Mailed copies.
Mar 2	10	Filed defts notice of deposition of Hale & Dorr, Samuel S. Dennis, Anil Khosla and Al Willard.
Mar 2		Issued summons on amended complaint on Kathleen Landreth, Ivan K. Landreth, Lucille Landreth, Thomas E. Landreth.
Mar 13	11	Filed defts notice of deposition of Samuel S. Dennis, III.
Mar 13	12	Filed defts affidavit of Mailing.
Mar 28	13	Filed marshal's return on s.c. of Kathleen Landreth, Ivan K. Landreth, Jr.
Mar 30	14	Filed marshal's return on s/c of Lucille Landreth.
Apr 7	15	Filed marshal's return on subpoenas Duces Tecum of Samuel S. Dennis, III.

DATE	NR.	PROCEEDINGS
1979		
Apr 10	16	Filed marshal's return on s/c of Thomas E. Landreth.
Apr 25	17	Filed defts notice of deposition of Jack P. Branch.
May 29	18	Filed return on service of deposition subpoena of Tonasket Timber Co., Att: Custodian of Records.
Jul 13	19	NOTICE OF DEPOSITIONS—of Custodian of Records of Warren & Brewster, Stan Neglay, Lyle Warren, Allan Lambert, Bob Brewster, Phil Harry, and Phil Fuller.
Jul 18	20	NOTICE OF DEPOSITIONS—of Custodian of Records of Pease & Beadling and Charles E. Pease, defts instance.
Jul 26		Ent. order directing counsel to file trial briefs and voir dire, instructions and agreed pretrial order by November 2, 1979, Counsel Notified.
Aug 8	21	RETURN ON SERVICE—of deposition subpoena of Custodian of Records for Pease & Beadling.
Aug 8	22	RETURN ON SERVICE—of deposition subpoena of Charles E. Pease.
Aug 21	23	NOTICE OF DEPOSITION—of Edward T. Engst, Eugene Graf & Issued, Patrick J. Peyton and Custodian of Records, Old National Bank, Tonasket, WA.
Aug 29	24	EDWARD ENGST'S RESPONSE—and objections to subpoena Duces Tecum.
Sept 7	25	DEFTS NOTICE—of deposition of Jack P. Branch.

DATE	NR.	PROCEEDINGS
1979		
Sept 10	26	DEFTS NOTICE—of deposition of Phil Fuller, Phil Harry, Harry Kennison, George Morrell.
Sept 12	27	LETTER—to counsel advising them that this case is now under the 39.1 ruling.
Oct 1	28	DEFTS NOTICE OF DEPOSITION—of Custodian of Records, Graham & Dunn & Issued.
Oct 1	29	DEFTS NOTICE OF DEPOSITION—of John Bolten, Sr. and custodian of Records, Hale & Dorr.
Oct 12	30	JOINT MOTION—to continue date for filing pretrial order. No Notice.
Oct 12		LODGED ORDER
Oct 16	31	ORDER—continuing date for lodging pretrial order, to March 14, 1980. Mailed copies.
Oct 25	32	RETURN ON DEPOSITION SUBPOENA—of John Bolten, Sr., with attachments.
Nov 8	33	PLTFS OBJECTIONS—to subpoenas
Nov 19	34	LETTER—from Guy P. Michelson regards the settlement conference. <i>Court Grants</i> —your letter request to extend the settlement conference date to Dec. 10, 1979 under the provisions of Rule 39.1 (c).
Nov 19		ENT ORDER—court continues the due date for settlement conference to Dec. 10, 1979 under rule 39.1 (c).
Dec 11	35	DEFTS NOTICE—of deposition of Phillip Cook.
Dec 26	36	DEFTS NOTICE—of deposition of Harry Kennison.

DATE	NR.	PROCEEDINGS
1980		
Jan 25		ENT ORDER—court directs counsel to file a notice of selection of mediator and a status report on (sic) later than February 15, 1980.
Feb 1	37	LETTER—from James A. Smith, and Malcolm L. Edwards regards a status report.
Feb 6	38	DEFTS NOTICE—of deposition of Custodian of records for Rainier National Bank.
Feb 11	39	DEFTS RETURN—on Deposition subpoena of Custodian of Records, for Rainier Nat. Bank.
Apr 2		ENT ORDER—transferring case to Judge William Enright and scheduled for trial period of May 5-16, 1980. Pretrial order to be filed April 23, Trial briefs due April 30, 1980. Counsel advised.
Apr 10	40	DEFTS NOTICE—of deposition of Harry Kennison.
Apr 15	41	RETURN—on deposition subpoena of Harry Kennison.
Apr 25	42	LETTER—from John W. Hathaway regards requesting a continuance of the trial date.
May 1		ENT ORDER—case con't from Judge Enright's May Calendar to November 17, 1980 before Judge Sharp for trial. PTO and Trial briefs due October 31, 1980. Counsel Advised.
May 19	43	LETTER—from William Dwyer regards a status conference, no settlement has been reached still set for trial.
June 11	44	DEFTS NOTICE—of deposition of Robert Ingram, J. Thomas Wood and George Morrell.
June 12	45	RETURN ON DEPOSITION SUBPOENAS—of Robert Ingram.

DATE	NR.	PROCEEDINGS
1980		
June 16	46	AFFIDAVIT—of service of Deposition subpoena of J. Thomas Wood.
Jul 14	47	NOTICE OF DEPOSITION—of Eugene Graf, behalf plaintiff.
Jul 16	48	RETURN ON SERVICE—deposition subpoena to Eugene Graf behalf pltf.
Jul 22	49	ORDER of Transfer from Judge Sharp to Judge Rothstein. cc to Counsel.
Aug. 7	50	PLAINTIFF'S NOTICE of Deposition of Custodian of Records for Midvalley Bank. Subpoena Issued.
	51	PLTF'S MOTION for leave to amend complaint.
	52	NOTICE of Motion for Leave to Amend Complaint. Noted for 8/22/80.
	53	BRIEF in support of Motion for leave to amend Complaint.
Aug. 7		LODGED Second Amended Complaint and <i>JURY DEMAND</i> .
Aug. 8	54	AFFIDAVIT of Service of Notice of Motion for Leave to amend Complaint.
	55	AFFIDAVIT of Service of Subpoena on JANE M. McCormach.
Aug. 18	56	AFFIDAVIT of IVAN K. LANDRETH in opposition to Pltf's motion for leave to amend its complaint.
	57	DEFENDANTS' MEMORANDUM in opposition to Pltf's motion for leave to amend its complaint.
	58	AFFIDAVIT of James A. Smith, Jr.

DATE	NR.	PROCEEDINGS
1980		
Aug. 19	59	AFFIDAVIT of IVAN K. LANDRETH in opposition to Pltf's motion for leave to amend its complaint.
Aug. 20	60	LETTER to Counsel from clerk re pre-trial conf. of Oct. 24, 1980 at 10 A.M.
	61	PLTF'S REPLY to Defts' memorandum in opposition to Pltf's motion for leave to amend its complaint.
	62	AFFIDAVIT of John W. Hathaway in support of Motion to amend complaint.
Aug. 26	63	Defts' NOTICE of Deposition of Peter H. Townsend—Issued.
Aug. 27	64	AFFIDAVIT OF SERVICE of Deposition Subpoena.
Aug. 29	65	NOTICE of Deposition of A. L. McKimney
Sept 9	66	RETURN ON DEPOSITION SUBPOENA—of Peter H. Townsend.
Sep 25	67	MOTION of defts. for summary judgment on securities claim
"	68	MEMORANDUM in support of defts' Motion for s.j.
"	69	AFFIDAVIT of James A. Smith, Jr.
"	70	AFFIDAVIT of Ivan K. Landreth, Sr.
"	71	NOTICE of defts' Motion for s.j. for 10/17/80
Oct. 7		Received LETTER, motion for Summary Judgment on Securities Claims cont. two Weeks to Oct. 31, 1980.



DATE	NR.	PROCEEDINGS
1980		
Oct. 14		ENT. the preliminary pre-trial conference calendared for Oct. 24, 1980 at 10:00 a.m. is ordered stricken and will be re-set at the convenience of counsel and the Court. cc to counsel.
Oct. 16	72	DEFTS' SECOND MOTION for partial summary judgment.
	73	NOTICE OF DEFTS' SECOND MOTION—Noted for 11/7/80.
	74	AFFIDAVIT of Ivan K. Landreth, Sr. in support of Defts' second motion.
	75	AFFIDAVIT of James A. Smith, Jr. in support of Defts' Second Motion for Partial Summary Judgment.
Oct. 16		LODGED STIPULATION continuing Defts' motion for summary Judgment on securities Claims.
	76	MEMORANDUM in support of Defts' Second Motion for Partial Summary Judgment.
Oct. 22	77	ORDER continuing Defts' motion for summary judgment on Securities Claim to Oct. 31, 1980. cc: to Counsel of Record.
Oct. 23	78	DEFTS' MOTION to Compel production of Documents and Information
	79	NOTICE of consideration of Defts' motion to compel production of documents and information; and request for hearing. Noted for 11/7/80.
	80	DEFTS' MEMORANDUM in support of Motion to Compel Production of Documents and Information.
	81	AFFIDAVIT of Guy P. Michelson.

DATE	NR.	PROCEEDINGS
1980		
Oct. 22		ENT. upon the court's on motion, it is ordered that trial in this case is continued from Nov. 17, 1980 to Feb. 9, 1981 at 9:30 A.M.
Oct. 28		ENT. Pltf's response to Defts' motion for Summary Judgment, filed Sept. 25, 1980 shall be filed on or before Nov. 7, 1980. Pltf's response to Defts' second motion for Summary Judgment, filed Oct. 16, 1980 shall be filed on or before Nov. 12, 1980.
Oct. 31	82	DEFTS' NOTICE OF DEPO. of Custodians of Records: Pack River Management Company, W-I Forest Products, Inc.
Nov. 3	83	AFFIDAVIT of John W. Hathaway in opposition to Defts' motion to compel.
Nov. 4	84	ORDER granting leave to amend complaint. cc: counsel of Record.
	85	PLTF'S MEMORANDUM in opposition to Defts' motion to compel.
Nov. 5	86	AFFIDAVIT of Service of Order granting Defts' second motion etc.
	87	AFFIDAVIT of Service of Notice of Consideration of Defts' motion to compel production of documents etc.
Nov. 7	88	DEFTS' NOTICE of Deposition of James M. Harrison, Warren S. Cooper.
Nov. 7	89	DEFTS' REPLY MEMORANDUM in support of Motion to compel production of Documents and Information.
	90	AFFIDAVIT of Guy P. Michelson.
		LODGED Order compelling production of Documents & Information

DATE	NR.	PROCEEDINGS
1980		
Nov. 10	91	MEMORANDUM in opposition to Defts' first motion for summary Judgment on Securities Claims.
	92	AFFIDAVIT of Samuel S. Dennis in opposition to Defts' motion for Summary Judgment.
	93	AFFIDAVIT of John W. Hathaway in opposition to Defts' motion for Summary Judgment on Securities Claims.
Nov. 12	94	AFFIDAVIT of Service.
	95	AFFIDAVIT of Service of Defts' motion for Summary Judgment and affidavit of James Smith & Ivan Landreth.
Nov 14	96	DEFTS' NOTICE of Deposition: Custodian of Records, First Natl. Bank of Boston.  LETTER to Judge Rothstein from John Hathaway requesting extension of time to file responses—Granted. Now due on 11/10/80 & 11/14/80.
Nov. 14	97	DEFT'S REPLY to Pltf's Memorandum in opposition to Defts' first motion for summary judgment on Securities Claims.
	98	SUPPLEMENTAL AFFIDAVIT of Guy P. Michelson supporting Defts' motion for Summary Judgment on Securities Claims.
	99	PLTF'S MEMORANDUM in opposition to Defts' second motion for partial Summary Judgment on Federal and State Securities Acts and Damages.
Nov. 17	100	Motion to strike portions of affidavit of Samuel S. Dennis submitted in opposition to Defts' motion for summary judgment.

DATE	NR.	PROCEEDINGS
1980		
	101	NOTICE OF CONSIDERATION of Defts' motion to strike portions of Affidavit of Samuel S. Dennis in opposition to Defts' motion for Summary Judgment. Noted for Dec. 5, 1980.
	102	MEMORANDUM in support of Defts' motion to Strike portions of affidavit of Samuel S. Dennis submitted in opposition to Defts' motion for summary judgment.
	103	AFFIDAVIT of Guy P. Michelson in support of Defts' motion to Strike.
Nov. 21	104	DEFTS' REPLY to Pltf's Memorandum in opposition to Defts' second motion for partial summary judgment.
	105	AFFIDAVIT of Ivan K. Landreth.
Dec 1	106	PLTF'S Memorandum in opposition to Defts' motion to strike portion of the Affidavit of Samuel S. Dennis.
	107	ABSTRACT of Deposition of Philip Cook.
	108	AFFIDAVIT of John W. Hathaway in opposition to Defts' motion to Strike.
Dec 2	109	DEFTS' NOTICE of DEPOSITION of John M. Lotz and Custodian of Records, Hidden Hills Land Co.
Dec. 4	110	DEFTS' REPLY to Pltf's Memorandum opposing motion to strike portions of Samuel S. Dennis' Affidavit (Submitted opposition to Defts' first summary judgment motion).
	111	AFFIDAVIT of Service.
Dec 9	112	PLTFS' RESPONSE TO DEFTS' REPLY to Pltfs' Memorandum opposing Deft's motion to strike portions of Dennis' affidavit.

DATE	NR.	PROCEEDINGS
1980		
Dec. 11	113	DEFTS' RENOTE OF DEPOSITION of John M. Lotz and Custodian of Records, HIDDEN HILLS AND COMPANY.
Jan 7	114	AFFIDAVIT of John W. Hathaway in support of Pltf's motion for Summary Judgment on Securities Claims.
	115	PLTF'S MOTION for Summary Judgment on Securities Claims.
	116	NOTICE of Consideration of Pltf's motion for Summary Judgment on Securities Claims, noted for 1/23/81 at 10:00 A.M. Oral argument requested.
	117	PLTF'S MEMORANDUM in support of Motion for Summary Judgment on Securities Claims.
	118	NOTICE of Default. (Pltf's)
1981		
Jan 8	119	NOTICE of Consideration of Pltfs' motion for Summary Judgment on Securities Claims.
Jan 9		Reed Letter from Mr. Michelson to Mr. Hathaway re Defts have until Jan. 14, 1981 to file an answer to Pltf's Second amended Complaint.
Jan 14	120	ANSWER and Affirmative Defenses to Pltf's second amended complaint and Counterclaims of Defendants Ivan K. Landreth and Lucille Landreth, husband and wife; Thomas E. Landreth; Ivan K. Landreth, Jr., and Kathleen Landreth, husband and wife. DEMAND FOR JURY.
Jan 22		LOGED Stipulation and Order for extension of Time.

DATE	NR.	PROCEEDINGS
1981		
Jan 30	121	ORDER for extension of Time (Stip.) filing of Defts' opposition to Pltf's Memorandum in Support of Motion for Summary Judgment on Securities Claims—Extended to 2/2/81. cc: to Counsel.
Feb 2		ENT. in Chambers: at the request of the parties, the Court orders that the trial now scheduled for Feb. 9, 1981 is vacated. The Court calendars a status conference at 10:00 A.M. on April 10, 1981 at which time a new trial date will be established and set.
	122	DEFTS' MEMORANDUM opposing Pltf's motion for summary judgment on Securities Claims.
	123	AFFIDAVIT of Ivan K. Landreth opposing Pltf's Motion for Summary Judgment on Securities Claims.
	124	AFFIDAVIT of Guy P. Michelson
Feb 5	125	AFFIDAVIT of Service. (Doc. #122-124)
Feb 9	126	PLTF'S MEMORANDUM in Response to Defts' Memorandum opposing Pltf's motion for Summary Judgment on Securities Claims.
	127	AFFIDAVIT of John W. Hathaway.
Feb 17	128	SUPPLEMENTAL AFFIDAVIT of Guy P. Michelson in Opposition to Pltf's Motion for Summary Judgment.
Feb 18	129	GUY P. MICHELSON'S AFFIDAVIT supporting Defts' Reply.
	130	DEFTS' REPLY to Pltf's Memorandum in Response to Defts' Memorandum opposing Pltf's Motion for Summary Judgment on Securities Claims.



DATE	NR.	PROCEEDINGS
1981		
Feb 19	131	LETTER from Bogle & Gates—re Status Conference cont to 4/17/81 at 10:00 A.M.
Feb 24	132	SUPPLEMENTAL AFFIDAVIT of Guy P. Michelson in support of Defts' position that this transaction was not a Sale of Securities because Defts retained neither control nor any ownership interest in the Corporation after the sale.
Feb 25	133	DEFTS' SUPPLEMENTARY MEMORANDUM in support of Position that this transaction was not a sale of Securities because Defts retained neither control nor any ownership interest in the Corporation after the Sale.
Feb 26	134	PLTF'S RESPONSE TO DEFENDANTS' SECOND REPLY MEMORANDUM in opposition to Defts' Motion for Summary Judgment on Securities Claims.
Feb 26	135	AFFIDAVIT of John W. Hathaway in support of Pltf's Response to Second Reply.
	136	PLTF'S SUPPLEMENTAL MEMORANDUM in support of its motion for Summary Judgment that Defts' offer and sale of stock in Landreth Timber Co., Inc. to Pltf's purchasing group and others constitute a sale of Security to which the Federal Securities Laws apply.
	137	AFFIDAVIT of Peter Townsend in support of Pltf's motion for Summary Judgment.
Feb 27		ORAL ARGUMENT on cross motions for Summary Judgment on Securities claim held. Both counsel argue their respective positions on the motions to the Court. The court makes advisory rulings and orders the motions to stand submitted.

DATE	NR.	PROCEEDINGS
1981		
Mar 19	138	PLTF'S MOTION for Reconsideration.
	139	NOTICE of Consideration of Pltf's motion for Reconsideration. 4/10/81
	140	BRIEF in support of Pltf's motion for Reconsideration.
**Mar 17	141	LETTER—from Mr. Michelson re: weather (sic) the sale of Landreth Timber Co. constituted the sale of securities—Schedule 3/19/81 the parties to exchange Requests for Admissions regarding facts.  3/25/81—answers to each request will be exchanged by parties.  3/30/81—parties will meet in an effort to resolve disputed issues of fact.  4/3/81—parties will submit to the Court a listing of disputed and undisputed facts, affidavits, Briefs, etc.
Apr 3	142	TRANSCRIPT—proceedings B4 J. Rothstein 2/27/81.
Apr 6	143	MEMORANDUM—Defts' in support of the Court's Preliminary Decision regarding Summ. Jdmt., & oppos. to Pltf's Mot. for reconsideration.
Apr 7	144	MEMORANDUM—Defts' in Support of Motion for Sum. Jdmt.
	145	MEMORANDUM—Pltf Supplemental concerning presence of Investment Contract.
Apr 15	146	MEMORANDUM—Pltf's reply in opposition to defts' memo in support of mot for sum. jdmt. debt retain on (sic) control over business after closing.

DATE	NR.	PROCEEDINGS
1981		
	147	REPLY—Pltf's to Defts' Memo in opposition to Pltf's mot for reconsideration.
	148	AFFIDAVIT—Supplemental of Samuel S. Dennis in opposition to Deft mot for sum. jdmt.
Apr 16	149	REPLY—Defts' to Pltf's supplemental memo re investment contract.
	150	AFFIDAVIT—Guy P. Michelson attny for Defts.
Apr 17		ENT. Hearing Held: The Court orders Pltf's motion for reconsideration DENIED. Deft's motion for sum. Jdmt. on issue of control is GRANTED. Court shall prepare formal order.
	151	AFFIDAVIT—Guy P. Michelson.
Apr 29	152	ORDER—granting deft's motion summary judgment. Pltf's mot for reconsideration is DENIED. cc: to Cnsl.
May 27	153	JUDGMENT—defts' mot for summ jdmt is granted. Pltf's mot for reconsideration is DENIED. cc: to Cnsl.
May 26	154	APPEAL—notice of Pltf. cc: to CCA w/notification of payment. cc: to cnsl of record.
May 29	155	NOTICE Landreth's amended, of apeal. cc: cnsl, CCA
Jun 10	156	CERTIFICATE—regarding transcript of proceedings, Mailed to CCA & Counsel the certificate of record.
Jun 15	157	APPELLEES DESIGNATION—of transcript of proceedings. copy to Court reporter.
14 July	158	ORDER of dismissal cc: cnsl BJR
15 July	159	TRANSCRIPT 4-17-81 proceedings

DATE	NR.	PROCEEDINGS
1981		
20 July	160	NOTICE pltf's, of appeal (order of dismissal) *
		*all documents processed & forwarded to CCA (et)
	161	DESIGNATION pltf's, of no transcript (this appeal)

UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

No. 81-3446

LANDRETH TIMBER COMPANY,  
*Plaintiff-Appellant,*

vs.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR.  
and KATHLEEN LANDRETH, husband and wife,  
*Defendants/Appellees.*

RELEVANT DOCKET ENTRIES

DATE	FILINGS-PROCEEDINGS
1981	
Jul 23	DOCKETED CAUSE AND ENTERED APPEARANCES OF COUNSEL FOR APLT. AND APLE.
Jul 23	FILED CERTIFICATE OF RECORD. (N/T) ogm
Jul 23	APPELLANT'S OPENING BRIEF DUE: SEPTEMBER 1, 1981. ogm
Aug 25	Filed, as of 8/24/81 in 81-3280, Order (Wallace & Norris) Upon consideration of aplt's motion to consolidate appeals in 81-3280 and 81-3446 and to adjust the briefing schedules, appeal 81-3280 is dismissed for lack of jurisdiction. The documents before the court reflect that the order appealed from in 81-3280 did not dispose of all claims in the action and was not certified for appeal under Fed. R. Civ. P. 54(b). Aplt's motion to consolidate the appeals is denied as moot. ck
Sept 3	Filed orig and 15 copies of aplt's opening brief and 5 copies of the excerpt of record, (9/1/81). lb

DATE	FILINGS-PROCEEDINGS
1981	
Oct 8	Filed orig & 15 copies of aples' answering brief. (10/5) ck
Oct 26	Fld mtn & ord (CLK) gntg appellant an ext of time to file the reply brief to: 10-27-81. bbm
Oct 29	Filed orig and 15 copies of aplt's reply 10/27/81. lb
Nov 5	Filed as of 7/23/81, RECORD ON APPEAL IN 7 Volumnes, PLEDGS VOL., I, II, III, IV, V, VI, ORIG ONLY, CERT COPY, R/T's Vol., VII ORIG ONLY. lb
1982	
Feb 25	Recvd Orig & 15 SEC Amicus Curiae Briefs. (2/24)c jc
Feb 25	Filed Motion of The SEC for leave to file memorandum as amucus curiae out of time. (CIVATT with copies of amicus briefs.) jc
Mar 8	Filed Order, (FLETCHER), The court issues the following order: (a) the motion of the Securities and Exchange Commission for leave to file a late amicus curiae brief is granted, and the brief already received is ordered filed; and (b) aple's may file a supplemental brief not to exceed seven (7) pages in response to the amicus curiae brief on or before fourteen (14) days from the entry of this order. lb
Mar 8	Filed orig and 15 copies of SEC amicus briefs. (2/24/82). lb
Mar 10	Filed aple's memorandum in opposition to the Securities and Exchange Commission's motion for leave to file memorandum out of time, to CIVATT, 3/8/82. lb
Mar 12	Filed aple's motion for reconsideration of order granting SEC leave to file amicus curiae brief out of time and for an extension of time for filing reply brief, to CIVATT, 3/12/82. lb



DATE	FILINGS-PROCEEDINGS
1981	
Mar 19	Filed Order, (FLETCHER, AND REINHARDT, Circuit Judges), Upon consideration of aple's opposition and motion for reconsideration, the court's March 8, 1982 order granting the Securities and Exchange Commission leave to file a brief as amicus curiae is affirmed. Aple's motion for an extension of time through April 19, 1982 to file their supplemental brief is granted. The supplemental brief shall not exceed ten (10) pages. lb
Apr 27	Filed as of 4/23/82, orig and 15 copies of aple's brief, (10 pages), (4/19/82). jw
Aug 12	Filed aple's additional citations, to Panel. 8/10/82. lb
Aug 30	Filed aplt's additional citations, to Panel, 8/27/82. lb
Sept 7	Filed as of 9/2/82, SEC motion for leave to participate in oral argument, to Panel, 9/1/82. lb
Sept 7	Filed aple's memorandum in opposition to motion of the SEC for leave to participate in oral argument, to Panel, 9/3/82. lb
Sept 8	ARGUED AND SUBMITTED BEFORE: BROWNING, TUTTLE (11th Circuit), REINHARDT, CJJ. lb
Sept 8	Filed as of 9/7/82, Order, (Clk of Ct), In response to the motion by the Amicus Curiae requesting permission to argue before the court in this cause calendared in Seattle on September 8, it is ordered that the amicus may argue within the thirty (30) minutes allowed to aplt as is agreed to between the parties. lb
Sept 9	Filed aplt's additional citations, to Panel. lb
Sept 20	Filed aple's response to aplt's citation, to Panel, 9/16/82. lb

DATE	FILINGS-PROCEEDINGS
1981	
Nov 15	Filed aplt's motion to add parties plaintiff, memorandum in support of motion and affidavit of Malcolm L. Edwards, to PANEL, 11/11/82. lb
Nov 23	Filed as of 11/2, aple's memorandum in opposition to aplt's motion to add parties plaintiff, (11/22/82), to PANEL. jw
Dec 14	Filed, as of Dec. 3, aplt's amendment to its mtn to add parties pltf; and aplt's reply to aple's opposition to aplt's mtn to add parties pltf. (panel) 12/1 -db-
1983	
Jan 3	Filed Order (Dpty clrk) Judge Farris has been drawn to replace Judge Reinhardt on this case. The panel is now Judges Browning, Tuttle, and Farris. dm
Jan 20	Filed Order (BROWNING, TUTTLE & FARRIS) Because of the unavoidable withdrawal of Judge Reinhardt from further participation in this case, it is resubmitted to the panel of Judges Browning, Tuttle, and Farris. Judge Farris will listen to the tapes of oral argument and participate in further deliberations and in the decision. dm
Mar 03	Filed Order (BROWNING, TUTTLE & FARRIS) Aplt's motion to add parties Plaintiff is submitted for decision with the merits of the appeal. dm
Mar 31	Rec'd letter dated 3/30/83 from counsel for amicus (SEC) re: add'l citations, PANEL. dm
June 13	Rec'd aple's supplemental authorities, (6/10), (PANEL). dm
June 21	Rec'd as of June 20, ltr dtd June 16, from counsel for aplt, re: response to aple's supplemental authorities. (panel) -db-

DATE	FILINGS-PROCEEDINGS
1984	
Mar 07	ORDERED OPINION FILED (BROWNING) AND JUDG TO BE ENTD. dm
Mar 07	FILED OPINION—AFFIRMED. PLTFS' MOTION FILED 11/15/82 IS DENIED. dm
Mar 07	FILED AND ENTERED JUDGMENT. dm
Mar 19	Filed, as of 3/15, in Seattle, aples' bill of costs, (3/15). dm
Mar 23	Rec'd from counsel for Aples' letter dated 3/21/84. RE: Inaccuracies in opinion. (PANEL) ru
Mar 29	MANDATE ISSUED
Apr 02	Filed, as of 3/23, aplt's objection to aples' bill of costs, (3/22). dm
Apr 04	Filed Order (DPTY CLK) Upon due consideration of the bill of costs of aples and the objection thereto, aples are awarded costs as follows: aples' brief—\$111.72; aples' supplemental brief - \$37.18 - TOTAL - \$148.90. Costs incurred in the preparation and transmission of the record are taxable in the district court. See Fed. R. App. P. 39(e). dm
Apr 04	MANDATE ISSUED—AMENDED TO INCLUDE COSTS. dm
Apr 24	Filed Order (BROWNING, TUTTLE & FARRIS) The opinion dated March 7, 1984 is modified to delete the entire paragraph beginning: "For a variety of reasons, Landreth II . . .," slip op. at 13. The following shall be added to the beginning of the following paragraph: Landreth II was unprofitable. It sold the mill, and went into receivership. dm.
June 11	Rec'd SC notice of filing petition for cert on 5/31, SC#83-1961. dm
Nov 28	Rec'd as of Nov. 16, copy of supreme court order filed Nov. 13, 1984, granting petition for writ of certiorari. (panel) -db-

UNITED STATES DISTRICT COURT  
FOR THE WESTERN DISTRICT OF WASHINGTON

Civil Action No. \_\_\_\_\_

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

vs.

IVAN K. LANDRETH and JANE DOE LANDRETH, husband  
and wife, THOMAS E. LANDRETH and MARY DOE LAN-  
DRETH, husband and wife, IVAN K. LANDRETH, JR. and  
SARA DOE LANDRETH, husband and wife,  
*Defendants.*

COMPLAINT

1. This is an action by the plaintiff Landreth Timber Company, Inc., to recover for violations of sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77l(2) and 77q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5 of the Securities and Exchange Commission, 17 C.R.F. § 250.10b-5; sections 21.20.010 and 21.20.430 of the Securities Act of Washington, RCW § 21.20.010 and § 21.20.430; and the common law of the State of Washington arising from the sale of securities to the plaintiff Landreth Timber Company, Inc., by the defendants Ivan K. Landreth, Thomas E. Landreth, and Ivan K. Landreth, Jr.

THE PARTIES

2. The plaintiff, the Landreth Timber Company, Inc. (hereinafter "Landreth Timber II"), is a corporation organized and existing under the laws of the State of Delaware with a principal place of business in Tonasket, Washington. The plaintiff Landreth Timber II is, as a result of a merger, the survivor of the B & D Company,



Inc., which, by the purchase of the securities at issue herein, acquired all of the outstanding shares of stock in the Landreth Timber Company, Inc., a corporation organized and existing under the laws of the State of Washington (hereinafter "Landreth Timber I"). The plaintiff Landreth Timber II is engaged in the business of logging, processing and finishing raw timber, and selling finished lumber products.

3. The defendant Ivan K. Landreth is a citizen of the State of Washington and resides in Oroville, Washington; all acts herein alleged to have been performed by, for or with the knowledge of Ivan K. Landreth were for and to his individual benefit and the benefit of the marital community composed of he and Jane Doe Landreth.

4. The defendant Thomas E. Landreth is a citizen of the State of California and resides in Irvine, California; all acts herein alleged to have been performed by, for or with the knowledge of Thomas E. Landreth were for and to his individual benefit and the benefit of the marital community composed of he and Mary Doe Landreth.

5. The defendant Ivan K. Landreth, Jr., is a citizen of the State of Washington and resides in Oroville, Washington; all acts herein alleged to have been performed by, for or with the knowledge of Ivan K. Landreth, Jr., were for and to his individual benefit and the benefit of the marital community composed of he and Sara Doe Landreth.

#### JURISDICTION

6. The jurisdiction of this Court is invoked pursuant to section 22(a) of the Securities Act of 1933, as amended 15 U.S.C. 77v(a); and section 27 of the Securities Exchange Act of 1934, as amended 15 U.S.C. § 78aa. The jurisdiction of this Court is also invoked pursuant to 28 U.S.C. § 1331 as this action arises under the laws of the United States. The amount in con-

troversy exceeds the sum or value of ten thousand dollars (\$10,000) exclusive of interest or costs. This Court has pendant jurisdiction over those claims arising under the laws of the State of Washington.

#### COUNT I

7. On or about August 15, 1977, Jack P. Branch, as agent of the defendants Ivan K. Landreth, Thomas E. Landreth and Ivan K. Landreth, Jr.,<sup>1</sup> contacted Samuel S. Dennis (hereinafter "Mr. Dennis") and proposed that Mr. Dennis purchase from the defendants all of the outstanding shares of stock of Landreth Timber I. Landreth Timber I was, at all relevant times, engaged in the business of logging, processing and finishing raw timber, and selling finished lumber products.

8. On numerous and diverse occasions during the months of August and September, 1977, Mr. Dennis met; communicated and corresponded with the defendant Ivan K. Landreth and Jack P. Branch as agent for the defendants. During the course of those meetings and communications, the defendants informed Mr. Dennis that the mill used by Landreth Timber I to process and finish raw timber had been destroyed by fire in or about May, 1977, and therefore was not operative. The defendants further informed Mr. Dennis that the mill was being reconstructed; that the bulk of the equipment to be installed in the reconstructed mill had been purchased; and that the completion of reconstruction was imminent.

9. During the course of the meetings and communications more fully described in Paragraph 8 above, the defendants, as an inducement to purchase the defendants' securities, represented to Mr. Dennis that:

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<sup>1</sup> "Defendants" hereinafter refers to Ivan K. Landreth, Thomas E. Landreth and Ivan K. Landreth, Jr.



(a) All of the equipment to be installed in the reconstructed mill was in good operating condition and suitable for use in the reconstructed mill;

(b) The value of the raw timber inventory on the premises of Landreth Timber I exceeded thirty thousand dollars (\$30,000);

(c) The structural steel required to complete reconstruction of the mill had been purchased and delivered;

(d) The cost to Mr. Dennis of completing reconstruction of the mill would not exceed one hundred fifty thousand dollars (\$150,000);

(e) Upon completion, the reconstructed mill would have the capacity to process two hundred thousand (200,000) board feet of lumber daily, operating on a double shift basis; and

(f) The Helle portion of the mill would be operative by the end of October, 1977, and the Maxi-Mill would be operative by the end of November, 1977.

10. On or about October 6, 1977, Mr. Dennis, acting in good faith and in reasonable reliance upon the representations and assurances of the defendants more fully described in Paragraph 9 above, entered into a "Stock Purchase Agreement" with the defendants pursuant to the terms of which Mr. Dennis, as an accommodation buyer, agreed to purchase, and the defendants agreed to sell, all of the outstanding shares of Landreth Timber I.

11. In the Stock Purchase Agreement, the defendants made numerous express representations to Mr. Dennis concerning the assets of the corporation, the physical assets of the mill, the reconstruction of the mill and the operating liabilities of the reconstructed mill. These representations are fully set forth in the Stock Purchase Agreement, but included, *inter alia*, (i) that the mill was being constructed with first-quality and suitable equipment in a workmanlike manner, (ii) that the mill, upon

completion, if properly operated, would produce an overrun of at least fifty percent (50%) of the presently accepted, so-called, "Standard Scribner Scale" for measuring logs, (iii) that all other equipment presently used in the mill was suitable for their designated purposes and in good operating condition, and (iv) that the financial representations contained in the exhibits to the Stock Purchase Agreement were true and correct.

12. On or about October 29, 1977, Phillip Cook, who had been retained by plaintiff upon the recommendation of Jack P. Branch, met with the defendant Ivan K. Landreth for the purpose of examining the facilities and equipment on the premises of Landreth Timber I and to review the progress of the reconstruction of the mill. Ivan K. Landreth restricted Mr. Cook's examination of the mill and its employees. During the course of that meeting, the defendant Ivan K. Landreth represented that:

(a) The equipment installed in the reconstructed mill was in good operating condition and capable of finishing and processing two hundred thousand (200,000) board feet of lumber daily, on a double shift schedule;

(b) The equipment not installed and required to complete reconstruction of the mill had been ordered and purchased and, when installed, would be capable of finishing and processing two hundred thousand (200,000) board feet of lumber daily, on a double shift schedule;

(c) The structural steel required to complete reconstruction of the mill, including the log deck to the Maxi-Mill, had been purchased and delivered;

(d) The yellow pine log inventory of Landreth Timber I had been purchased and delivered in the spring of 1977; and

(e) The completion of reconstruction of the mill was "on schedule," the schedule referred to being that war-

ranted in the Stock Purchase Agreement (see Paragraph 9(f) above).

13. On or about November 4, 1977, Mr. Dennis, in reliance upon the representations and assurances of the defendants, and in accordance with the terms and conditions of the Stock Purchase Agreement more fully described in Paragraphs 10 and 11 above, caused the B & D Company, Inc. (hereinafter "B & D Company") to be organized and incorporated under the laws of the State of Delaware. The B & D Company was organized for the purpose of acquiring the defendants' shares of stock in Landreth Timber I.

14. On or about November 7, 1977, Mr. Dennis assigned, and the B & D Company accepted assignment of the Stock Purchase Agreement governing the purchase of the shares of Landreth Timber I. Pursuant to the terms and conditions of the "Assignment and Acceptance of Assignment and Assumption" between Mr. Dennis and the B & D Company, the B & D Company succeeded to all of the rights and obligations of Mr. Dennis under the Stock Purchase Agreement.

15. On or about November 16, 1977, Mr. Dennis, as an officer and agent of the B & D Company, met with the defendant Ivan K. Landreth to affect the consummation of the purchase by B & D Company of all of the outstanding shares of Landreth Timber I. At that time, the defendant Ivan K. Landreth, acting for himself and as agent for the defendants Thomas E. Landreth and Ivan K. Landreth, Jr., again represented that upon completion of reconstruction of the mill, the equipment contained therein would have the capacity to process two hundred thousand (200,000) board feet of lumber daily. The defendant Ivan K. Landreth further represented that the cost to the B & D Company of completion of reconstruction of the mill would total approximately one hundred thirty-nine thousand dollars (\$139,000). Ivan K. Landreth also confirmed the warranties and repre-

sentations made in the Stock Purchase Agreement and specifically confirmed those set forth in Paragraph 9 above.

16. At the conclusion of the discussions more fully described in Paragraph 15 above, the B & D Company, in reliance upon the representations, assurances and warranties of the defendants, and the defendants entered into an "Assignment of, and Amendment to, Stock Purchase Agreement" (hereinafter "Amended Stock Purchase Agreement") pursuant to the terms of which the B & D Company purchased from the defendants all of the outstanding shares of stock of Landreth Timber I for the sum of three million nine hundred fifty-three thousand ninety-five dollars (\$3,953,095.00). The Amended Stock Purchase Agreement amended certain provisions of the Stock Purchase Agreement and confirmed, adopted and incorporated by reference, those terms, warranties, representations and conditions of the Stock Purchase Agreement, which were not expressly amended.

17. On November 17, 1977, Ivan K. Landreth, acting for himself and as attorney-in-fact for Thomas E. Landreth and Ivan K. Landreth, Jr., executed a Certificate, which certified, *inter alia*:

"(2) all of the representations and warranties made by the sellers and by the company to the buyer in the Stock Purchase Agreement are true and correct in all material respects as of the date of this Certificate, with the same force and effect as though such representations and warranties had been made as of the date hereof;"

18. In the Amended Stock Purchase Agreement, the defendants expressly represented, *inter alia*, that the accounts payable of Landreth Timber I on November 16, 1977, totalled three thousand five hundred dollars (\$3,500.00) and that the cost to the B & D Company of



completing reconstruction of the mill would total one hundred thirty-six thousand seven hundred eighty-nine dollars (\$136,789.00).

19. Upon execution of the Amended Stock Purchase Agreement, the B & D Company was merged with its newly acquired subsidiary Landreth Timber I; the shares of stock in the merged Landreth Timber I purchased from the defendants were cancelled; and the name of the surviving B & D Company was changed to the Landreth Timber Company, Inc. The surviving Landreth Timber II succeeded to all of the rights and obligations of the B & D Company under the Stock Purchase Agreement and Amended Stock Purchase Agreement.

20. The sale of all the outstanding shares of Landreth Timber I by the defendants to the B & D Company constituted a purchase and sale of securities within the meaning of sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 771(2) and 77q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5; and sections 21.20.010 and 21.20.430 of the Securities Act of Washington. RCW § 21.20.010 and § 21.20.430.

21. The oral and written warranties, representations and assurances made by the defendants and more fully described in Paragraphs 8 through 18 above constituted misrepresentations and untrue statements of material facts in violation of sections 12(2) and 17(a) of the Securities Act of 1933; and Section 10(b) of the Securities Exchange Act of 1934 in that:

(a) The defendants misrepresented the condition and capabilities of the equipment installed, and to be installed, in the reconstructed mill;

(b) The defendants misrepresented that the equipment and structural steel required to complete reconstruction of the mill had been purchased;

(c) The defendants understated the liabilities and obligations of Landreth Timber I and failed to disclose information concerning the actual liabilities and obligations of Landreth Timber I to the representatives of Mr. Dennis and the B & D Company.

(d) The defendants misrepresented the age, condition and value of the raw timber inventory of Landreth Timber I;

(e) The defendants misrepresented the cost to Mr. Dennis and the B & D Company of completing the reconstructed mill;

(f) The defendants misrepresented the capacity of the reconstructed mill to process and produce finished lumber products by substantially overstating the capacity of the mill; and

(g) The defendants knew that the representations and warranties which they had made were not true or, with the exercise of reasonable care could have determined that those representations were not true.

22. In further violation of sections 12(2) and 17(a) of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934, the defendants continually failed and omitted to state material facts concerning the cost of completion of the reconstructed mill; the condition and capabilities of the equipment installed and to be installed in the reconstructed mill; the liabilities and obligations of Landreth Timber I; the purchase and delivery of equipment and structural steel required to complete construction of the mill; the age, condition and value of the raw timber inventory of Landreth Timber I; and the capacity of the reconstructed mill to process and produce finished timber products. Each of the material facts which the defendants failed and omitted to state were necessary in order to make statements made, in the light of the circumstances under which they



were made, not misleading. The defendants knew of such omissions or, with the exercise of reasonable care would have known of such omissions.

23. The misrepresentations and omissions more fully described in Paragraphs 8-18 and 21-22 above were made in and by the use of instrumentalities of interstate commerce.

24. As a direct and proximate result of the good faith reliance of the plaintiff and its predecessors in interest upon the misrepresentations, assurances and warranties of the defendants, the plaintiff, through its predecessors, purchased the securities in issue from the defendants at a price which substantially exceeded the actual value of those securities at the time of sale in that:

(a) The equipment installed in the reconstructed mill was not in good operating condition and suitable for use in the reconstructed mill as represented by the defendants;

(b) Additional equipment and structural steel to be installed in the reconstructed mill had not been ordered and purchased as represented by the defendants;

(c) The liabilities and obligations of Landreth Timber I substantially exceeded those represented by the defendants;

(d) The cost of completing reconstruction of the mill substantially exceeded the cost represented by the defendants;

(e) The time required for completing reconstruction of the mill substantially exceeded that represented by the defendants;

(f) The capacity of the reconstructed mill was substantially less than that represented by the defendants; and

25. As a direct and proximate result of the good faith reliance of the plaintiff and its predecessors in interest

upon the misrepresentations, assurances and warranties of the defendants,

(a) The plaintiff Landreth Timber II has incurred substantial expense in refurbishing and replacing equipment which was not in accord with the representations of the defendants;

(b) The plaintiff Landreth Timber II has incurred substantial expense in purchasing equipment and structural steel for use in completing reconstruction of the mill which the defendants had represented had been purchased and delivered;

(c) The plaintiff Landreth Timber II has incurred substantial expense in satisfying the liabilities and obligations of Landreth Timber I which the defendants had concealed from the plaintiff and its predecessors in interest;

(d) The plaintiff Landreth Timber II has expended substantial amounts of time and has incurred substantial expense, in excess of the representations of the defendants, in completing the reconstruction of the mill;

(e) The plaintiff Landreth Timber II has lost business and profits which it otherwise would have realized from its business operations if the capacity of the reconstructed mill had been as represented by the defendants;

(f) The plaintiff Landreth Timber II has lost business and profits which it otherwise would have realized from the processing and sale of its raw timber inventory if the condition, age and value of its raw timber inventory had been as represented by the defendants; and

(g) The plaintiff Landreth Timber II has lost business and profits which it otherwise would have realized from its business operations if the mill would have been capable of completion within the "schedule" warranted and represented by the defendants; and

(h) The plaintiff Landreth Timber II sustained substantial loss on the sale of assets of the mill, which it otherwise would have realized if the representation of defendants had been true.

26. The plaintiff Landreth Timber II makes such tender of the Landreth Timber I shares which it purchased (including reissuance) as may be required by law.

### COUNT II

27. The plaintiff Landreth Timber II reallages and incorporates herein the allegations contained in Paragraphs 1 through 26 above.

28. The representations, assurances and omissions of the defendants more fully described above constituted misrepresentations, misstatements and omissions to state material facts in violation of section 21.20.010 of the Securities Act of Washington. RCW § 21.20.010 and § 21.20.430.

### COUNT III

29. The plaintiff Landreth Timber II realleges and incorporates herein the allegations contained in Paragraphs 1 through 26 above.

30. The misrepresentations, misstatements and omissions to state material facts more fully described above were knowingly made by the defendants in order to induce the plaintiff through Mr. Dennis and the B & D Company, to purchase securities from the defendants and constituted fraud, misrepresentations and deceit under the common law of the State of Washington.

### COUNT IV

31. The plaintiff Landreth Timber II realleges and incorporates herein the allegations contained in Paragraphs 1 through 26 above.

32. The plaintiff Landreth Timber II and its predecessors in interest satisfied each and every obligation imposed upon them by the terms and conditions of the Assignment of, and Amendment to, Stock Purchase Agreement.

33. The defendants have, as more particularly set forth in Paragraphs 7 through 24, breached the terms, warranties, representations and conditions of the Assignment of, and Amendment to, Stock Purchase Agreement.

34. By virtue of defendants' breaches of the Assignment of, and Amendment to, Stock Purchase Agreement, the plaintiff has incurred the expenses, losses and damages enumerated in Paragraph 25 above.

WHEREFORE, the plaintiff Landreth Timber Company, Inc. prays:

1. That, upon such tender of the securities in issue (including reissue thereof), as may be required by law, the Court enter judgment for the plaintiff against the defendants, and each of them for damages in the amount of the consideration paid to the defendants by the plaintiff and its predecessors in interest for those securities, together with interest;

2. That the Court enter judgment for the plaintiff against the defendants for additional damages to be proven at trial, but which are at the least two million five hundred thousand dollars (\$2,500,000.00), together with interest;

3. That the Court enter judgment for the plaintiff against the defendants for costs and reasonable attorneys' fees including, but without limitation, reasonable attorneys' fees incurred in the reissue and tender of the securities in issue; and

4. That the Court grant such other and further relief as it deems just and proper.

DATED this 1st day of November, 1978.

GRAHAM & DUNN

By /s/ GERALD T. PARKS, JR.  
Attorneys for Plaintiff,  
Landreth Timber Company, Inc.

UNITED STATES DISTRICT COURT  
FOR THE WESTERN DISTRICT OF WASHINGTON

\_\_\_\_\_  
Civil Action No. \_\_\_\_\_

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

v.

IVAN K. LANDRETH and JANE DOE LANDRETH, husband  
and wife, THOMAS E. LANDRETH and MARY DOE LAN-  
DRETH, husband and wife, IVAN K. LANDRETH, JR. and  
SARA DOE LANDRETH, husband and wife,  
*Defendants.*

[Filed Dec. 15, 1978]

\_\_\_\_\_  
FIRST AMENDED COMPLAINT AND JURY DEMAND

AMENDED COMPLAINT

1. This is an action by the plaintiff Landreth Timber Company, Inc., to recover for violations of sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 771(2) and 17q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 250.10b-5; sections 21.20.010 and 21.20.430 of the Securities Act of Washington, RCW § 21.20.010 and § 21.20.430; and the common law of the State of Washington arising from the sale of securities to the plaintiff Landreth Timber Company, Inc., by the defendants Ivan K. Landreth, Thomas E. Landreth, and Ivan K. Landreth, Jr.



## THE PARTIES

2. The plaintiff, the Landreth Timber Company, Inc. (hereinafter "Landreth Timber II"), is a corporation organized and existing under the laws of the State of Delaware with a principal place of business in Seattle, Washington. The plaintiff Landreth Timber II is, as a result of a merger, the survivor of the B & D Company, Inc., which, by the purchase of the securities at issue herein, acquired all of the outstanding shares of stock in the Landreth Timber Company, Inc., a corporation organized and existing under the laws of the State of Washington (hereinafter "Landreth Timber I"). The plaintiff Landreth Timber II is engaged in the business of logging, processing and finishing raw timber, and selling finished lumber products.

3. The defendant Ivan K. Landreth is a citizen of the State of Washington and resides in Oroville, Washington; all acts herein alleged to have been performed by, for or with the knowledge of Ivan K. Landreth were for and to his individual benefit and the benefit of the marital community composed of he and Jane Dole Landreth.

4. The defendant Thomas E. Landreth is a citizen of the State of California and resides in Irvine, California; all acts herein alleged to have been performed by, for or with the knowledge of Thomas E. Landreth were for and to his individual benefit and the benefit of the marital community composed of he and Mary Doe Landreth.

5. The defendant Ivan K. Landreth, Jr., is a citizen of the State of Washington and resides in Oroville, Washington; all acts herein alleged to have been performed by, for or with the knowledge of Ivan K. Landreth, Jr., were for and to his individual benefit and the benefit of the marital community composed of he and Sara Doe Landreth.

## JURISDICTION

6. The jurisdiction of this Court is invoked pursuant to section 22(a) of the Securities Act of 1933, as amended 15 U.S.C. 77v(a); and section 27 of the Securities Exchange Act of 1934, as amended 15 U.S.C. § 78aa. The jurisdiction of this Court is also invoked pursuant to 28 U.S.C. § 1331 as this action arises under the laws of the United States. The amount in controversy exceeds the sum or value of ten thousands dollars (\$10,000) exclusive of interest or costs. This Court has pendant jurisdiction over those claims arising under the laws of the State of Washington.

## COUNT I

7. On or about August 15, 1977, Jack P. Branch, as agent of the defendants Ivan K. Landreth, Thomas E. Landreth and Ivan K. Landreth, Jr.,<sup>1</sup> contacted Samuel S. Dennis (hereinafter "Mr. Dennis") and proposed that Mr. Dennis purchase from the defendants all of the outstanding shares of stock of Landreth Timber I. Landreth Timber I was, at all relevant times, engaged in the business of logging, processing and finishing raw timber, and selling finished lumber products.

8. On numerous and diverse occasions during the months of August and September, 1977, Mr. Dennis met, communicated and corresponded with the defendant Ivan K. Landreth and Jack P. Branch as agent for the defendants. During the course of those meetings and communications, the defendants informed Mr. Dennis that the mill used by Landreth Timber I to process and finish raw timber had been destroyed by fire in or about May, 1977, and therefore was not operative. The defendants further informed Mr. Dennis that the mill was being reconstructed; that the bulk of the equipment to be installed in

<sup>1</sup> "Defendants" hereinafter refers to Ivan K. Landreth, Thomas E. Landreth and Ivan K. Landreth, Jr.

the reconstructed mill had been purchased; and that the completion of reconstruction was imminent.

9. During the course of the meetings and communications more fully described in Paragraph 8 above, the defendants, as an inducement to purchase the defendants' securities, represented to Mr. Dennis that:

(a) All of the equipment to be installed in the reconstructed mill was in good operating condition and suitable for use in the reconstructed mill;

(b) The value of the raw timber inventory on the premises of Landreth Timber I exceeded thirty thousand dollars (\$30,000);

(c) The structural steel required to complete reconstruction of the mill had been purchased and delivered;

(d) The cost to Mr. Dennis of completing reconstruction of the mill would not exceed one hundred fifty thousand dollars (\$150,000);

(e) Upon completion, the reconstructed mill would have the capacity to process two hundred thousand (200,000) board feet of lumber daily, operating on a double shift basis; and

(f) The Helle portion of the mill would be operative by the end of October, 1977, and the Maxi-Mill would be operative by the end of November, 1977.

10. On or about October 6, 1977, Mr. Dennis, acting in good faith and in reasonable reliance upon the representations and assurances of the defendants more fully described in Paragraph 9 above, entered into a "Stock Purchase Agreement" with the defendants pursuant to the terms of which Mr. Dennis, as an accommodation buyer, agreed to purchase, and the defendants agreed to sell, all of the outstanding shares of Landreth Timber I.

11. In the Stock Purchase Agreement, the defendants made numerous express representations to Mr. Dennis

concerning the assets of the corporation, the physical assets of the mill, the reconstruction of the mill and the operating liabilities of the reconstructed mill. These representations are fully set forth in the Stock Purchase Agreement, but included, *inter alia*, (i) that the mill was being constructed with first-quality and suitable equipment in a workmanlike manner, (ii) that the mill, upon completion, if properly operated, would produce an overrun of at least fifty percent (50%) of the presently accepted, so-called, "Standard Scribner Scale" for measuring logs, (iii) that all other equipment presently used in the mill was suitable for their designated purposes and in good operating condition, and (iv) that the financial representations contained in the exhibits to the Stock Purchase Agreement were true and correct.

12. On or about October 29, 1977, Phillip Cook, who had been retained by plaintiff upon the recommendation of Jack P. Branch, met with the defendant Ivan K. Landreth for the purpose of examining the facilities and equipment on the premises of Landreth Timber I and to review the progress of the reconstruction of the mill. Ivan K. Landreth restricted Mr. Cook's examination of the mill and its employees. During the course of that meeting, the defendant Ivan K. Landreth represented that:

(a) The equipment installed in the reconstructed mill was in good operating condition and capable of finishing and processing two hundred thousand (200,000) board feet of lumber daily, on a double shift schedule;

(b) The equipment not installed and required to complete reconstruction of the mill had been ordered and purchased and, when installed, would be capable of finishing and processing two hundred thousand (200,000) board feet of lumber daily, on a double shift schedule;

(c) The structural steel required to complete reconstruction of the mill, including the log deck to the Maxi-Mill, had been purchased and delivered;



(d) The yellow pine log inventory of Landreth Timber I had been purchased and delivered in the spring of 1977; and

(e) The completion of reconstruction of the mill was "on schedule," the schedule referred to being that warranted in the Stock Purchase Agreement (see Paragraph 9(f) above).

13. On or about November 4, 1977, Mr. Dennis, in reliance upon the representations and assurances of the defendants, and in accordance with the terms and conditions of the Stock Purchase Agreement more fully described in Paragraphs 10 and 11 above, caused the B & D Company, Inc. (hereinafter "B & D Company") to be organized and incorporated under the laws of the State of Delaware. The B & D Company was organized for the purpose of acquiring the defendants' shares of stock in Landreth Timber I.

14. On or about November 7, 1977, Mr. Dennis assigned, and the B & D Company accepted assignment of the Stock Purchase Agreement governing the purchase of the shares of Landreth Timber I. Pursuant to the terms and conditions of the "Assignment and Acceptance of Assignment and Assumption" between Mr. Dennis and the B & D Company, the B & D Company succeeded to all of the rights and obligations of Mr. Dennis under the Stock Purchase Agreement.

15. On or about November 16, 1977, Mr. Dennis, as an officer and agent of the B & D Company, met with the defendant Ivan K. Landreth to affect the consummation of the purchase by B & D Company of all of the outstanding shares of Landreth Timber I. At that time, the defendant Ivan K. Landreth, acting for himself and as agent for the defendants Thomas E. Landreth and Ivan K. Landreth, Jr., again represented that upon completion of reconstruction of the mill, the equipment contained therein would have the capacity to process two hundred

thousand (200,000) board feet of lumber daily. The defendant Ivan K. Landreth further represented that the cost to the B & D Company of completion of reconstruction of the mill would total approximately one hundred thirty-nine thousand dollars (\$139,000). Ivan K. Landreth also confirmed the warranties and representations made in the Stock Purchase Agreement and specifically confirmed those set forth in Paragraph 9 above.

16. At the conclusion of the discussions more fully described in Paragraph 15 above, the B & D Company, in reliance upon the representations, assurances and warranties of the defendants, and the defendants entered into an "Assignment of, and Amendment to, Stock Purchase Agreement" (hereinafter "Amended Stock Purchase Agreement") pursuant to the terms of which the B & D Company purchased from the defendants all of the outstanding shares of stock of Landreth Timber I for the sum of three million nine hundred fifty-three thousand ninety-five dollars (\$3,953,095.00). The Amended Stock Purchase Agreement amended certain provisions of the Stock Purchase Agreement and confirmed, adopted and incorporated by reference, those terms, warranties, representations and conditions of the Stock Purchase Agreement, which were not expressly amended.

17. On November 17, 1977, Ivan K. Landreth, acting for himself and as attorney-in-fact for Thomas E. Landreth and Ivan K. Landreth, Jr., executed a Certificate, which certified, *inter alia*:

"(2) all of the representations and warranties made by the sellers and by the company to the buyer in the Stock Purchase Agreement are true and correct in all material respects as of the date of this Certificate, with the same force and effect as though such representations and warranties had been made as of the date hereof;"

18. In the Amended Stock Purchase Agreement, the defendants expressly represented, *inter alia*, that the ac-



counts payable of Landreth Timber I on November 16, 1977, totalled three thousand five hundred dollars (\$3,500.00) and that the cost to the B & D Company of completing reconstruction of the mill would total one hundred thirty-six thousand seven hundred eighty-nine dollars (\$136,789.00).

19. Upon execution of the Amended Stock Purchase Agreement, the B & D Company was merged with its newly acquired subsidiary Landreth Timber I; the shares of stock in the merged Landreth Timber I purchased from the defendants were cancelled; and the name of the surviving B & D Company was changed to the Landreth Timber Company, Inc. The surviving Landreth Lumber II succeeded to all of the rights and obligations of the B & D Company under the Stock Purchase Agreement and Amended Stock Purchased Agreement.

20. The sale of all the outstanding shares of Landreth Timber I by the defendants to the B & D Company constituted a purchase and sale of securities within the meaning of sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77l(2) and 77q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5; and sections 21.20.010 and 21.20.430 of the Securities Act of Washington. RCW § 21.20.010 and § 21.20.430.

21. The oral and written warranties, representations and assurances made by the defendants and more fully described in Paragraphs 8 through 18 above constituted misrepresentations and untrue statements of material facts in violation of sections 12(2) and 17(a) of the Securities Act of 1933; and Section 10(b) of the Securities Exchange Act of 1934 in that:

(a) The defendants misrepresented the condition and capabilities of the equipment installed, and to be installed, in the reconstructed mill;

(b) The defendants misrepresented that the equipment and structural steel required to complete reconstruction of the mill had been purchased;

(c) The defendants understated the liabilities and obligations of Landreth Timber I and failed to disclose information concerning the actual liabilities and obligations of Landreth Timber I to the representatives of Mr. Dennis and the B & D Company.

(d) The defendants misrepresented the age, condition and value of the raw timber inventory of Landreth Timber I;

(e) The defendants misrepresented the cost to Mr. Dennis and the B & D Company of completing the reconstructed mill;

(f) The defendants misrepresented the capacity of the reconstructed mill to process and produce finished lumber products by substantially overstating the capacity of the mill; and

(g) The defendants knew that the representations and warranties which they had made were not true or, with the exercise of reasonable care could have determined that those representations were not true.

22. In further violation of sections 12(2) and 17(a) of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934, the defendants continually failed and omitted to state material facts concerning the cost of completion of the reconstructed mill; the condition and capabilities of the equipment installed and to be installed in the reconstructed mill; the liabilities and obligations of Landreth Timber I; the purchase and delivery of equipment and structural steel required to complete construction of the mill; the age, condition and value of the raw timber inventory of Landreth Timber I; and the capacity of the reconstructed mill to process and produce finished timber products. Each of the material facts which the defendants failed and omitted to state were

necessary in order to make statements made, in the light of the circumstances under which they were made, not misleading. The defendants knew of such omissions or, with the exercise of reasonable care would have known of such omissions.

23. The misrepresentations and omissions more fully described in Paragraphs 8-18 and 21-22 above were made in and by the use of instrumentalities of interstate commerce.

24. As a direct and proximate result of the good faith reliance of the plaintiff and its predecessors interest upon the misrepresentations, assurances and warranties of the defendants, the plaintiff, through its predecessors, purchased the securities in issue from the defendants at a price which substantially exceeded the actual value of those securities at the time of sale in that:

(a) The equipment installed in the reconstructed mill was not in good operating condition and suitable for use in the reconstructed mill as represented by the defendants;

(b) Additional equipment and structural steel to be installed in the reconstructed mill had not been ordered and purchased as represented by the defendants;

(c) The liabilities and obligations of Landreth Timber I substantially exceeded those represented by the defendants;

(d) The cost of completing reconstruction of the mill substantially exceeded the cost represented by the defendants;

(e) The time required for completing reconstruction of the mill substantially exceeded that represented by the defendants;

(f) The capacity of the reconstructed mill was substantially less than that represented by the defendants; and

25. As a direct and proximate result of the good faith reliance of the plaintiff and its predecessors in interest upon the misrepresentations, assurances and warranties of the defendants,

(a) The plaintiff Landreth Timber II has incurred substantial expense in refurbishing and replacing equipment which was not in accord with the representations of the defendants;

(b) The plaintiff Landreth Timber II has incurred substantial expense in purchasing equipment and structural steel for use in completing reconstruction of the mill which the defendants had represented had been purchased and delivered;

(c) The plaintiff Landreth Timber II has incurred substantial expense in satisfying the liabilities and obligations of Landreth Timber I which the defendants had concealed from the plaintiff and its predecessors in interest;

(d) The plaintiff Landreth Timber II has expended substantial amounts of time and has incurred substantial expense, in excess of the representations of the defendants, in completing the reconstruction of the mill;

(e) The plaintiff Landreth Timber II has lost business and profits which it otherwise would have realized from its business operations if the capacity of the reconstructed mill had been as represented by the defendants;

(f) The plaintiff Landreth Timber II has lost business and profits which it otherwise would have realized from the processing and sale of its raw timber inventory if the condition, age and value of its raw timber inventory had been as represented by the defendants; and

(g) The plaintiff Landreth Timber II has lost business and profits which it otherwise would have realized from its business operations if the mill would have been capa-



ble of completion within the "schedule" warranted and represented by the defendants; and

(h) The plaintiff Landreth Timber II sustained substantial loss on the sale of assets of the mill, which it otherwise would have realized if the representation of defendants had been true.

26. The plaintiff Landreth Timber II makes such tender of the Landreth Timber I shares which it purchased (including reissuance) as may be required by law.

### COUNT II

27. The plaintiff Landreth Timber II realleges and incorporates herein the allegations contained in Paragraphs 1 through 26 above.

28. The representations, assurances and omissions of the defendants more fully described above constituted misrepresentations, misstatements and omissions to state material facts in violation of section 21.20.010 of the Securities Act of Washington. RCW § 21.20.010 and § 21.20.430.

### COUNT III

29. The plaintiff Landreth Timber II realleges and incorporates herein the allegations contained in Paragraphs 1 through 26 above.

30. The misrepresentations, misstatements and omissions to state material facts more fully described above were knowingly made by the defendants in order to induce the plaintiff, through Mr. Dennis and the B & D Company, to purchase securities from the defendants and constituted fraud, misrepresentations and deceit under the common law of the State of Washington.

### COUNT IV

31. The plaintiff Landreth Timber II realleges and incorporates herein the allegations contained in Paragraphs 1 through 26 above.

32. The plaintiff Landreth Timber II and its predecessors in interest satisfied each and every obligation imposed upon them by the terms and conditions of the Assignment of, and Amendment to, Stock Purchase Agreement.

33. The defendants have, as more particularly set forth in Paragraphs 7 through 24, breached the terms, warranties, representations and conditions of the Assignment of, and Amendment to, Stock Purchase Agreement.

34. By virtue of defendants' breaches of the Assignment of, and Amendment to, Stock Purchase Agreement, the plaintiff has incurred the expenses, losses and damages enumerated in Paragraph 25 above.

### JURY DEMAND

35. Pursuant to the provisions of F.R.C.P. 38, the plaintiff requests that this matter be tried to a jury.

WHEREFORE, the plaintiff Landreth Timber Company, Inc. prays:

1. That, upon such tender of the securities in issue (including reissue thereof), as may be required by law, the Court enter judgment for the plaintiff against the defendants, and each of them for damages in the amount of the consideration paid to the defendants by the plaintiff and its predecessors in interest for those securities, together with interest;

2. That the Court enter judgment for the plaintiff against the defendants for additional damages to be proven at trial, but which are at the least two million five hundred thousand dollars (\$2,500,000.00), together with interest;

3. That the Court enter judgment for the plaintiff against the defendants for costs and reasonable attorneys' fees including, but without limitation, reasonable attor-



neys' fees incurred in the reissue and tender of the securities in issue; and

4. That the Court grant such other and further relief as it deems just and proper.

DATED this 15th day of December, 1978.

GRAHAM & DUNN

By /s/ GERALD T. PARKS, JR.

By /s/ R. BRUCE JOHNSTON

Attorneys for Plaintiff,  
Landreth Timber Company, Inc.

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

Civil Action No. C78-663S

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR., and KATHLEEN LANDRETH, husband and wife,  
*Defendants.*

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR., and KATHLEEN LANDRETH, husband and wife,  
*Counterclaim  
Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim  
Defendants.*

**ANSWER, AFFIRMATIVE DEFENSES, AND COUNTER-CLAIMS OF DEFENDANTS IVAN K. LANDRETH, AND LUCILLE LANDRETH, HUSBAND AND WIFE; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR., AND KATHLEEN LANDRETH, HUSBAND AND WIFE**

**DEMAND FOR JURY**

Defendants Ivan K. Landreth and Lucille Landreth, husband and wife, Thomas E. Landreth, and Ivan K. Landreth, Jr., and Kathleen Landreth, husband and wife

(hereinafter all "defendants") for answer to the First Amended Complaint of plaintiff Landreth Timber Company, Inc. (hereinafter "Landreth Timber II"), admit, deny, and allege as follows:

1. Answering paragraph 1 of the Complaint, defendants deny that such alleged violations have occurred and, therefore, deny the existence of jurisdiction.

2. Answering paragraph 2 of the Complaint, defendants are without knowledge or information sufficient to form a belief as to the truth or falsity of said paragraph and, therefore, deny the same.

3. Answering paragraph 3 of the complaint, defendants admit that Ivan K. Landreth is a citizen of the State of Washington residing in Redmond, Washington. Answering the balance of paragraph 3, defendants deny the same.

4. Answering paragraph 4 of the Complaint, defendants admit that Thomas E. Landreth is a citizen of the State of California. Answering the balance of paragraph 4, defendants deny the same.

5. Answering paragraph 5 of the Complaint, defendants admit that Ivan K. Landreth, Jr., is a citizen of the State of Washington, and is married to Kathleen Landreth. Answering the balance of paragraph 5, defendants deny the same.

6. Answering paragraph 6 of the Complaint, defendants deny the existence of jurisdiction.

7. Answering paragraph 7 of the Complaint, defendants deny that Jack P. Branch acted as defendants' agent, and specifically allege that Branch acted at all times as an agent of Samuel S. Dennis (hereinafter "Dennis") and plaintiff. Defendants are without knowledge or information sufficient to form a belief as to when Mr. Branch contacted Dennis, and therefore, deny said allegation. Defendants admit that the Landreth Timber

Company, Inc., as it existed prior to January 10, 1978, during defendants' ownership thereof (hereinafter "Landreth Timber I"), was at various times engaged in the business of logging, processing, and finishing raw timber and selling finished lumber products. Answering the balance of paragraph 7, defendants deny the same.

8. Answer (sic) paragraph 8 of the Complaint, defendants admit that from August through October, 1977, prior to execution of the Stock Purchase Agreement, Ivan K. Landreth (hereinafter "Landreth") met, communicated, and corresponded with Dennis or his agents. Defendants deny that Jack P. Branch acted as agent for defendants. Defendants allege that during the course of meetings, and communications, Landreth informed Dennis that the mill used by Landreth Timber I to process and finish raw timber had been destroyed by fire on or about May, 1977, was not operative, and was in the process of being reconstructed. Landreth told Dennis that arrangements had been made to acquire the bulk of the equipment for reconstruction of the mill, and requested that Dennis and his representatives contact the manufacturers of said equipment regarding the production capabilities, availability, installation, and completion of the equipment and the mill facility. Answering the balance of paragraph 8, defendants deny the same.

9. Answering paragraph 9 of the Complaint, defendants state that during the course of the meetings and communications occurring from August through October, 1977, prior to execution of the Stock Purchase Agreement, Landreth provided the following information to Dennis:

(a) With respect to the allegations of paragraph 9(a) of the Complaint, Landreth stated that the equipment installed in the mill, as of the date of the Stock Purchase Agreement dated October 6, 1977 (hereinafter the "Stock Purchase Agreement"), was suitable for its purpose and in good operating condition, normal wear and tear excepted. Landreth refused to provide a warranty concern-



ing equipment to be used in the mill operation and informed Dennis that additional equipment would be required if Dennis wanted to expand operations beyond those contemplated by Landreth. Landreth requested that Dennis perform his own investigation of the suitability, condition, and capability of the equipment.

(b) With respect to the allegations of paragraph 9(b) of the Complaint, defendants deny that such alleged representation was made, and allege that plaintiff retained its own appraisal and valuation experts to determine the amount of the raw timber inventory on the premises.

(c) With respect to the allegations of paragraph 9(c) of the Complaint, Landreth told Dennis that arrangements had been made for obtaining most of the structural steel required for reconstruction of the mill. Landreth did not state that most of the structural steel required to complete construction had been purchased and delivered.

(d) With respect to the allegations of paragraph 9(d) of the Complaint, Landreth told Dennis that his estimate of the cost of completing the mill as of that time, according to the capabilities and configuration of the mill as then planned and designed, would be approximately \$150,000, but Landreth refused to provide any warranty concerning this item and requested that Dennis perform his own investigation of the costs of completion.

(e) With respect to the allegations of paragraph 9(e) of the Complaint, Landreth orally told Dennis that he expected 80,000 to 100,000 board feet of lumber to be produced per shift by the mill facility as then planned and designed, but Landreth refused to provide any warranty concerning this item and requested that Dennis perform his own investigation of the capability of the mill.

(f) With respect to the allegations of paragraph 9(f) of the Complaint, Landreth told Dennis that he estimated that the Helle portion of the mill would be capable of operation by about October 31, 1977. In addition, Lan-

dreth stated that Warren and Brewster estimated completion of delivery of the Maxi-Mill equipment by the end of November, which would allow the Maxi-Mill to be operative by the end of December. Such projections at that time represented the best available estimate of the time of completion, and Landreth requested that Dennis contact the manufacturer of the Maxi-Mill equipment concerning the date of its availability.

Other than as specifically stated above, defendants deny that any warranties, guarantees, or further representations were provided concerning the above items. Answering the balance of paragraph 9, defendants deny the same.

10. Answering paragraph 10 of the Complaint, defendants state that on October 6, 1977, defendants and Landreth Timber I entered into the Stock Purchase Agreement with Dennis as amended on November 16, 1977. Answering the balance of paragraph 10, defendants deny the same.

11. Answering paragraph 11 of the Complaint, defendants state only that Landreth made such statements as are contained in the Stock Purchase Agreement on the terms set forth therein. Answering the balance of paragraph 11, defendants deny the same.

12. Answering paragraph 12 of the Complaint, defendants state that Landreth met with Phillip Cook (hereinafter "Cook") on or about October 29, 1977. Defendants deny that Landreth in any way restricted Cook's examination of the mill and its employees, beyond requesting that Cook not represent to such employees that he was manager prior to completion of the sale of Landreth Timber I, which had not yet closed as of the date of Cook's visit. Landreth provided the following information to Cook during that meeting:

(a) With respect to the allegations of paragraph 12(a) of the Complaint, Landreth told Cook that the used equip-



ment then installed in the reconstructed mill was either in good operating condition or was in the process of being reconditioned. Landreth stated that he believed that the mill facility, as then planned and designed, would be capable of producing approximately 80,000 to 100,000 board feet of lumber per shift.

(b) With respect to the allegations of paragraph 12(b) of the Complaint, defendants deny that Landreth stated that all equipment not installed and required to complete reconstruction of the mill had been ordered and purchased. Landreth stated that he believed that the mill facility, as then planned and designed, would be capable of producing approximately 80,000 to 100,000 board feet of lumber per shift.

(c) With respect to the allegations of paragraph 12(c) of the Complaint, defendants deny that Landreth told Cook that all structural steel required to complete reconstruction of the mill had been purchased and delivered.

(d) With respect to the allegations of paragraph 12(d) of the Complaint, defendants deny that any statement or representation was made concerning the date of purchase and delivery of the yellow pine log inventory, beyond stating to Cook that most of the log inventory in the yard had arrived before the fire occurring in May, 1977.

(e) With respect to the allegations of paragraph 12(e) of the Complaint, defendants deny that any warranty was made concerning the date of completion of the reconstruction of the mill. Landreth stated only that it would be at least until December before certain items of necessary equipment could be obtained based upon Warren and Brewster's most recent estimates. Landreth encouraged Cook to investigate the facts and circumstances regarding availability of equipment and completion of the mill.

Defendants deny that any warranties, guarantees, or further representations were provided concerning the

above items. Answering the balance of paragraph 12, defendants deny the same.

13. Answering paragraph 13 of plaintiff's Complaint, defendants are without knowledge or information sufficient to form a belief as to the truth or falsity of said paragraph, and therefore, deny the same.

14. Answering paragraph 14 of plaintiff's Complaint, defendants are without knowledge or information sufficient to form a belief as to the truth or falsity of said paragraph, and therefore, deny the same.

15. Answering paragraph 15 of plaintiff's Complaint, defendants admit that Landreth met with Dennis on or about November 16, 1977, in order to effect consummation of the purchase and sale of the shares of Landreth Timber I. Landreth acted for himself and as agent for defendants Thomas E. Landreth and Ivan K. Landreth, Jr., at such meeting. Defendants state only that such statements and representations were made by Landreth as are contained in the Stock Purchase Agreement. Answering the balance of paragraph 15, defendants deny the same.

16. Answering paragraph 16 of plaintiff's Complaint, defendants admit that B&D Company entered into an "Assignment of, and Amendment to, Stock Purchase Agreement" on November 16, 1977 (hereinafter "Amended Stock Purchase Agreement") on the basis and according to the terms set forth in that Amended Stock Purchase Agreement. Answering the balance of paragraph 16, defendants deny the same.

17. Answering paragraph 17 of plaintiff's Complaint, defendants admit that on or about November 17, 1977, Landreth, acting for himself and as attorney-in-fact for Thomas E. Landreth and Ivan K. Landreth, Jr., executed a certain Certificate which contains the terms and provisions stated and incorporated in that particular docu-

ment. Answering the balance of paragraph 17, defendants deny the same.

18. Answering paragraph 18 of plaintiff's Complaint, defendants deny that the Armed Stock Purchase Agreement stated that the accounts payable to Landreth Timber I as of November 16, 1977, were \$3,500. Defendants deny that any representation, guarantee, or warranty was made concerning the cost to B&D Company of completing reconstruction of the mill. Answering the balance of paragraph 18, defendants deny the same.

19. Answering paragraph 19 of plaintiff's Complaint, defendants are without knowledge or information sufficient to form a belief as to the truth or falsity of said paragraph, and therefore, deny the same.

20. Answering paragraph 20 of plaintiff's Complaint, defendants deny the same.

21. Answering paragraph 21 of plaintiff's Complaint, defendants deny the same.

22. Answering paragraph 22 of plaintiff's Complaint, defendants deny the same.

23. Answering paragraph 23 of plaintiff's Complaint, defendants deny the same.

24. Answering paragraph 24 of plaintiff's Complaint, defendants deny the same.

25. Answering paragraph 25 of plaintiff's Complaint, defendants deny the same.

26. Answering paragraph 26 of plaintiff's Complaint, defendants deny that Landreth Timber II has made any tender at any time or in any manner of the shares which it purchased from defendants. Further answering paragraph 26 of plaintiff's Complaint, defendants deny that Landreth Timber II now has the capacity or power to make such tender.

27. Answering paragraph 27 of plaintiff's Complaint, defendants reallege and incorporate the admissions, denials, and allegations contained in paragraphs 1 through 26 above.

28. Answering paragraph 28 of plaintiff's Complaint, defendants deny the same.

29. Answering paragraph 29 of plaintiff's Complaint, defendants reallege and incorporate the admissions, denials, and allegations contained in paragraphs 1 through 26 above.

30. Answering paragraph 30 of plaintiff's Complaint, defendants deny the same.

31. Answering paragraph 31 of plaintiff's Complaint, defendants reallege and incorporate the admissions, denials, and allegations contained in paragraphs 1 through 26 above.

32. Answering paragraph 32 of plaintiff's Complaint, defendants deny the same.

33. Answering paragraph 33 of plaintiff's Complaint, defendants deny the same.

34. Answering paragraph 34 of plaintiff's Complaint, defendants deny the same.

35. Answering paragraphs 1 through 4 of plaintiff's prayer for relief, defendants deny that such damages have been incurred, and further allege that there is no lawful basis for the recovery of such damages.

36. Further answering plaintiff's Complaint, defendants deny each and every other allegation not previously answered herein.

#### AFFIRMATIVE DEFENSES

By way of further answer as an affirmative defense to plaintiff's Complaint, and without prejudice to any other position taken herein, defendants allege as follows:



37. *Failure to Effect Service of Process and Properly Commence Suit.* Plaintiff has failed to effect service of process on all or a portion of the defendants herein and has failed to properly commence suit.

38. *Improper Value.* This action cannot be properly maintained in the United States District Court for the Western District of Washington.

39. *Lack of Standing and Capacity.* Plaintiff was never in privity with defendants, and plaintiff recently sold its stock in Landreth Timber II. For these and other reasons, plaintiff lacks the requisite standing and capacity to pursue its alleged claims against defendants.

40. *Failure to State a Claim Upon Which Relief Can be Granted.* Plaintiff has failed to state any claim in its Complaint upon which relief can be granted.

41. *Lack of any Warranty or Guaranty Concerning the Timing of Completion, Production Capability, or Eventual Cost of the Mill Facility.* There were extensive negotiations between the parties prior to execution of the Stock Purchase Agreement. While there are many warranties, guarantees, and representations by both parties contained in the Stock Purchase Agreement, defendants did not make any warranty concerning capital expenditures, the cost of completion, the timing of completion, or the production capabilities of the mill facility. Any statements regarding such items were made after extensive negotiations solely upon defendants' "information and belief," as opposed to any express or implied warranty on the part of defendants.

42. *Disclaimer of any Alleged Warranties Concerning the Mill Facility.* In the negotiations prior to execution of the Stock Purchase Agreement, defendants, both orally and in writing, expressly disclaimed the existence of any warranties or guarantees concerning capital expenditures, the cost of completing the mill facility, the timing of completion, or its production capabilities.

43. *Lack of Intent.* Intent to deceive, or reckless disregard of known facts, by defendants is a condition precedent to any potential liability under federal and state securities laws as alleged in plaintiff's Complaint. Defendants did not know, and in the exercise of reasonable care could not have known, of any alleged misrepresentation or omission.

44. *Lack of a Duty to Plaintiff and Defendants' Compliance with Applicable Standards of Care.* Defendants allege that they were not in any fiduciary relationship with plaintiff and deny that defendants owed any duty to plaintiff. Defendants further allege that they complied with all applicable standards of care.

45. *Negligence of Plaintiff.* Plaintiff and its agents were negligent in numerous respects, including, but not limited to, its investigation of the assets and liabilities of Landreth Timber I, the construction of the mill facility, the management of the mill facility, and in the production and use of certain appraisal, accounting, and other information used in the transaction. The claims and damages of plaintiff are totally or partially barred by plaintiff's own negligence, for defendants were not the proximate cause of plaintiff's alleged injury.

46. *Assumption of the Risk by Plaintiff.* Plaintiff entered into the Stock Purchase Agreement only after an extensive and lengthy investigation by appraisal, legal, and accounting personnel concerning the assets and liabilities of Landreth Timber I. Plaintiff had complete access to all of the records and operations of defendants in making such investigation and receiving such disclosure. Prior to closing on January 10, 1978, plaintiff knew of, and negotiated concerning, the claims which now form the basis of plaintiff's Complaint. The continued truth and correctness of defendants' representations were a condition precedent to closing under paragraph 5(d) and other provisions of the Stock Purchase



Agreement. After successfully negotiating an increase in the amount of the escrow because of the existence of certain claims now alleged by plaintiff, plaintiff then elected to proceed with closing. Plaintiff assumed as a matter of law and fact the risk of the matters now alleged in its Complaint.

47. *Latches.* Plaintiff knew of the existence of the claims which it has alleged in its Complaint prior to the closing of the transaction (hereinafter "closing") on January 10, 1978. Such alleged claims were discussed and taken into account in negotiations between the parties, including, but not limited to, those negotiations leading to the execution of the Amended Escrow Agreement. Plaintiff's failure to notify defendants and reassert such claims until shortly before commencement of this litigation constitutes laches, barring plaintiff's claims.

48. *General Estoppel and Waiver.* By its actions and omissions, plaintiff has otherwise waived and is estopped from asserting, the claims contained in its Complaint.

49. *Waiver and Estoppel: Plaintiff's Decision to Close the Transaction Despite Defendants' Alleged Non-Compliance With Conditions Precedent Under the Stock Purchase Agreement.* The continued correctness of defendants' representations and warranties, and the lack of changes in the financial condition of Landreth Timber I, were conditions precedent to closing under paragraphs 5(b), 5(d), and other provisions of the Stock Purchase Agreement. Prior to closing on January 10, 1978, plaintiff knew of, and negotiated concerning, the alleged breaches and misrepresentations contained in its Complaint. After negotiating an increase in the escrow, plaintiff exercised its option under paragraph 7(b) of the Stock Purchase Agreement to proceed with closing of the transaction. Plaintiff has waived, and is estopped from asserting, the claims now raised in its Complaint.

50. *Agency of Plaintiff's Accounting, Appraisal, and Other Personnel: Estoppel and Waiver.* Plaintiff employed certain investigative accountants, appraisers, and other personnel who became agents of plaintiff in connection with the purchase of the stock of Landreth Timber I and the events complained of in plaintiff's Complaint. Plaintiff availed itself of the complete disclosure provided by defendants, and plaintiff's agents actually participated and assisted in the preparation of financial, appraisal, and related data ultimately adopted, in whole or in part, by the parties in the Stock Purchase Agreement. Plaintiff's claims are barred by estoppel and waiver.

51. *Waiver: Election of Remedies.* Under paragraph 7(b) and other provisions of the Stock Purchase Agreement, plaintiff's remedies, in the event of an alleged default by defendants, were either (1) to waive default and require performance, or (2) to terminate the Stock Purchase Agreement. With full knowledge of the claims which it now asserts, plaintiff elected to waive the alleged default and proceeded to close the transaction on January 10, 1978, barring plaintiff's claims herein.

52. *Limitation of Remedies.* Under paragraph 7(b) and other provisions of the Stock Purchase Agreement, plaintiff's remedies, in the event of default, were either (1) to waive default and require performance, or (2) to terminate the Stock Purchase Agreement. Plaintiff selected neither of these options, and instead, has sold its stock and commenced this litigation, barring the claims asserted and remedies sought in plaintiff's Complaint.

53. *Limitation of Liability.* Under paragraph 7(b) and other provisions of the Stock Purchase Agreement, defendants' liability for the alleged claims asserted by plaintiff is limited to the amount presently held in escrow.

54. *Mutual Mistake.* All available information concerning projected costs of completion, timing of comple-

tion, production capabilities of the mill facility, and the assets and liabilities of Landreth Timber I were made fully available to plaintiff prior to entry into the Stock Purchase Agreement and closing. To the extent that actual costs, completion, production capabilities, and the assets and liabilities of Landreth Timber I deviated from the facts made known by plaintiff's own investigation, known by plaintiff, and/or disclosed by defendants, then the parties' joint reliance on such facts, as of the date of entry into the Stock Purchase Agreement and closing, constitutes a mutual mistake.

55. *Impossibility.* To the extent that eventual costs of completion, timing of completion, and the production capabilities of the mill facility deviated from those discovered by plaintiff and disclosed by defendants, then defendants allege that it was impossible to comply with such cost, time, or production capability estimates.

56. *Failure of Plaintiff to Comply With Conditions Precedent to Suit Under the Escrow Agreement.* Plaintiff has failed to comply with conditions precedent to making claims under the Escrow Agreement dated November 17, 1977 (hereinafter the "Escrow Agreement"), as amended on January 10, 1978 (hereinafter the "Amended Escrow Agreement"), including, but not limited to, failing to provide actual timely and complete notice of claims pursuant to the requirement of the Escrow Agreement, and failing to demonstrate that an actual bona fide dispute exists under the terms of the Escrow Agreement.

57. *Lack of Reliance by Plaintiff: Plaintiff's Actual Knowledge of Costs of Construction, Timing of Completion, Production Capability, and Other Circumstances Regarding Completion of the Mill.* Plaintiff was furnished, and availed itself of, a complete opportunity to investigate the assets and liabilities of Landreth Timber I, and the matters now claimed in its Complaint.

Plaintiff was encouraged to, and did, contact the manufacture of certain equipment used in the mill facility, and received complete information concerning the cost, timing of delivery of equipment, and production capabilities of the mill. Plaintiff relied on its own investigative efforts, not any alleged representations of defendants, in entering into this transaction. Defendants' representations made on "information and belief" were not material to plaintiff's decision to purchase Landreth Timber I, nor did plaintiff rely on said representations. Plaintiff had actual knowledge of the circumstances alleged in its Complaint, barring the claims which it has asserted herein.

58. *Compromise, Accord, and Satisfaction.* The claims now made by plaintiff were the subject of negotiations between the parties and were compromised and satisfied prior to closing.

59. *Statute of Frauds.* To the extent plaintiff's claims depend upon certain oral statements and representations not contained in the Stock Purchase Agreement, the Amendment to the Stock Purchase Agreement, the Escrow Agreement, the Amended Escrow Agreement, and such other written documents as may have become part of the agreement between the parties, then such claims are barred by the statute of frauds.

60. *Admission by Plaintiff Concerning the Value of the Assets and Liabilities of Landreth Timber I.* Defendants allege that the participation and production by plaintiff and its agents of accounting and appraisal data which became the agreed valuation of the assets and liabilities of Landreth Timber I in the Stock Purchase Agreement, constitute an admission by plaintiff concerning the value of such assets and liabilities, and certain other matters complained of in plaintiff's complaint, barring plaintiff's claims.

61. *Plaintiff's Failure to Mitigate Damages.* Plaintiff has failed to appropriately reduce and mitigate any



alleged damages after plaintiff obtained actual knowledge of the matters complained of in the Complaint. By refusing to meet with Landreth, terminating Landreth's employment agreement, by not asserting these claims until after it had sold its ownership interest in Landreth Timber II, and by its other actions and omissions, plaintiff also has deprived defendants of the opportunity to mitigate alleged damages.

62. *Plaintiff's Failure to Tender Shares to Defendants.* To the extent plaintiff's claims are based on an alleged rescission or tender offer to defendants, defendants deny that any such offer or tender has been made.

63. *Plaintiff's Changes in Design and Management Incurring Additional Costs.* After entry into the Stock Purchase Agreement, plaintiff made certain changes and alterations in the plans for construction of the mill as anticipated by defendants. Such changes in construction plans included the acquiring of additional equipment, the alteration of the design of the mill facility, different decisions in manufacture of timber products, and other management changes, all resulting in additional expenses for which defendants are not responsible.

64. *Bad Faith of Plaintiff.* Defendants incorporate by reference paragraphs 37 through 63 herein, and allege that plaintiff has acted in bad faith, barring plaintiff's claims.

### COUNTERCLAIM

By way of further answer and as a counterclaim to plaintiff's Complaint, and without prejudice to any other position taken herein, defendants allege as follows:

#### *Parties*

65. *Counterclaim Plaintiff:* Counterclaim plaintiff Ivan K. Landreth is a citizen of the State of Washington residing at 6515—159th N.E., Redmond, Washington.

66. Counterclaim plaintiff Thomas E. Landreth is a citizen of the State of California and resides at 205 Second Street, Hermosa Beach, California.

67. Counterclaim plaintiff Ivan K. Landreth, Jr., is a citizen of the State of Washington and resides at 12316 N. E. 68th Place, Kirkland, Washington.

68. *Counterclaim Defendant:* Counterclaim defendant Landreth Timber Company, Inc. ("Landreth Timber II"), on information and belief, is a corporation organized and existing under the laws of the State of Delaware, with a principal place of business in Seattle, Washington.

#### *Jurisdiction*

69. This Court has pendant jurisdiction over these counterclaims under the claim asserted in plaintiff's Complaint and under the Uniform Declaratory Judgments Act, RCW 7.24.010.

#### *Stock Purchase Agreement*

70. Following several months of negotiations, on October 6, 1977, counterclaim plaintiffs entered into a Stock Purchase Agreement with Samuel S. Dennis III ("Dennis") of Newton, Massachusetts.

71. Under the Stock Purchase Agreement, counterclaim plaintiffs agreed to sell and Dennis agreed to buy all 500 shares of common stock of Landreth Timber Company, Inc. ("Landreth Timber I"), for a total purchase price of \$3,400,000.

#### *Assignment of, and Amendment to, Stock Purchase Agreement*

72. On November 16, 1977, counterclaim plaintiffs, Dennis, and B&D Company, Inc. ("B&D") entered into an Assignment of, and Amendment to, Stock Purchase Agreement dated October 6, 1977 ("Amended Stock Purchase Agreement").



73. Under the Amended Stock Purchase Agreement, B&D was substituted for Dennis as buyer under the Stock Purchase Agreement. In addition, certain adjustments were made in the total purchase price and the payment schedule.

*Escrow Agreement*

74. On November 17, 1977, counterclaim plaintiffs and B&D entered into an Escrow Agreement ("Escrow Agreement") as anticipated by the Stock Purchase Agreement and Amended Stock Purchase Agreement.

75. Paragraph 4 of the Amended Stock Purchase Agreement provides that \$50,000 of the funds paid on November 17, 1977, and \$100,000 of the funds payable on January 10, 1978, shall be deposited with an escrow agent as security for the accuracy of the representations and warranties and the performance of the covenants made by the sellers under the Stock Purchase Agreement. Under the Escrow Agreement, Seattle-First National Bank was appointed as escrow agent. If the buyer is damaged as a result of a breach by the sellers of covenants, representations, or warranties in the Stock Purchase Agreement as amended, then the buyer has a right to seek reimbursement from the escrow fund. If the buyer and sellers cannot mutually agree on the existence and amount of damage, the escrow agent is instructed to hold the funds pending a final decision by either arbitration or a court of competent jurisdiction.

*Amendment to Escrow Agreement*

76. On January 10, 1978, counterclaim plaintiffs and Landreth Timber II entered into an "Amendment to Escrow Agreement" ("Amended Escrow Agreement"), amending the Escrow Agreement dated November 17, 1977. The Amended Escrow Amendment increased the escrow fund from \$150,000 to a total of \$300,000. This additional escrow fund was subject to all of the terms and conditions of the original Escrow Agreement.

**FIRST CAUSE OF ACTION:  
ACTION FOR DECLARATORY JUDGMENT**

77. Counterclaim plaintiffs reallege paragraphs 65 through 76 above.

78. Under paragraph 2.1 of the Escrow Agreement, the escrow fund is intended to secure the buyer against damages or losses resulting from any breach of representations and warranties or defaults in the performance by the sellers and Landreth Timber I of the Stock Purchase Agreement and the Amended Stock Purchase Agreement.

79. Under paragraph 2.2 of the Escrow Agreement, if the buyer and sellers cannot mutually agree upon such damage or loss, if any, the agent shall continue to hold the escrow funds until the rights of the parties have been agreed upon between the buyer and the sellers, or until the rights of the parties have been finally determined by arbitration pursuant to RCW 7.04 or by a court of competent jurisdiction.

80. Counterclaim plaintiffs and Landreth Timber I have not defaulted on any of their covenants and agreements contained in the Stock Purchase Agreement or the Amended Stock Purchase Agreement, nor have they breached any of their representations and warranties contained in the Stock Purchase Agreement and the Amended Stock Purchase Agreement. Counterclaim plaintiffs seek a declaratory judgment pursuant to RCW 7.24 that no such default or breach has occurred.

**SECOND CAUSE OF ACTION:  
MALICIOUS PROSECUTION**

81. Counterclaim plaintiffs realleges (sic) paragraphs 65 through 80 above.

82. Counterclaim defendant instituted this action with knowledge that the allegations set forth in plaintiff's

Complaint were false, unfounded, malicious, and without probable cause, in violation of RCW 4.24.350.

83. As a direct and proximate result of plaintiff's action, counterclaim plaintiffs have suffered damage, including harm to their reputation, emotional distress, injury to their business, humiliation, and costs and attorneys' fees incurred in defending this lawsuit.

#### PRAYER FOR RELIEF

WHEREFORE, counterclaim plaintiffs pray for judgment against the counterclaim defendant as follows:

1. That plaintiff's claim be dismissed with prejudice and without cost;
2. That this Court enter a judgment declaring that counterclaim plaintiffs and Landreth Timber I have not defaulted in the performance of any of their covenants and agreements contained in the Stock Purchase Agreement or the Amended Stock Purchase Agreement and have not breached any of their representations or warranties contained in the SPA or SPA Amendment;
3. That counterclaim plaintiffs be awarded damages for humiliation, emotional distress, harm to their business, and injury to their reputation, all as a result of plaintiff's action in filing this suit;
4. That counterclaim plaintiffs be awarded their expenses, costs, and reasonable attorneys' fees incurred herein; and
5. That counterclaim plaintiffs be awarded such other and further relief as the Court deems just and proper.

#### DEMAND FOR JURY

Defendants herein respectfully demand a jury pursuant to Rule 38(b) of the Federal Rules of Civil Procedure.

DATED this — day of December, 1978.

BOGLE & GATES

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JAMES A. SMITH, JR.

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GUY P. MICHELSON

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PATRICIA H. CHAR

Attorneys for Defendants/  
Counterclaim Plaintiffs

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

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Civil Action No. C78-663S

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR.,  
and KATHLEEN LANDRETH, husband and wife,  
*Defendants.*

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IVAN K. LANDRETH and LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR.,  
and KATHLEEN LANDRETH, husband and wife,  
*Counterclaim  
Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim  
Defendant.*

[Filed Jan. 15, 1979]

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**REPLY TO DEFENDANTS' COUNTERCLAIMS**

Plaintiff LANDRETH TIMBER COMPANY, INC., a Delaware corporation ("Landreth Timber II"), makes the following reply to defendants' counterclaims set forth in paragraphs 65 through 83 of their "Answer, Affirmative Defenses, and Counterclaims . . ." on file herein ("counterclaims"):

**REPLY**

Landreth Timber II replies to the counterclaims as follows:

**1. Admissions**

(a) Landreth Timber II admits paragraphs 65 through 68 of the counterclaims to the extent, but only to the extent, that the allegations were true at the time the counterclaims were filed.

(b) Landreth Timber II admits paragraph 69 to the extent, but only to the extent, that it may be construed as alleging that this court has jurisdiction to determine the rights of the parties to this action to the escrow funds held by Seattle-First National Bank pursuant to the "Escrow Agreement" and "Amendment to Escrow Agreement" identified below.

(c) Landreth Timber II admits paragraphs 70, 71, 72, 73, 74, 75, 76, 78 and 79 of the counterclaims to the extent, but only to the extent, that they contain averments that: (i) Samuel S. Dennis, 3d ("Dennis") and defendants entered into a "Stock Purchase Agreement" dated October 6, 1977; (ii) that Dennis, B & D Company, Inc. ("B & D") (to which Landreth Timber II is the successor) and defendants entered into an "Assignment of, and Amendment to, Stock Purchase Agreement Dated October 6, 1977" ("amended Stock Purchase Agreement") on November 16, 1977; (iii) that B & D and defendants entered into an "Escrow Agreement" on November 17, 1977; (iv) that Landreth Timber II and defendants entered into an "Amendment to Escrow Agreement" on January 10, 1977; and (v) that those documents contain the terms and provisions stated and incorporated in them.

**2. Denials**

Landreth Timber II denies each and every averment contained in the counterclaims and each and every con-



clusion or inference which may be drawn therefrom which is not expressly admitted elsewhere in this answer, including, without limitation, each and every averment, conclusion or inference contained in paragraphs 80, 82 and 83; in paragraph 69 to the extent not hereinabove specifically admitted; in paragraphs 70, 71, 72, 73, 74, 75, 76, 78 and 79 to the extent not hereinabove specifically admitted.

### 3. *Restatement of Responses*

Landreth Timber II responds to paragraphs 77 and 81 of the counterclaims as it responded to those other paragraphs of the counterclaims incorporated by reference into paragraphs 77 and 81.

### 4. *Denial of Inferences*

While portions of the counterclaims, such as the last sentence of paragraph 80 do not, by their terms, require any response by Landreth Timber II, Landreth Timber II expressly denies any conclusions or inferences which might be drawn from any statement in the counterclaims not hereinabove specifically admitted, including, without limitation, any conclusion or inference to the effect that defendants or any of them are entitled to any relief whatsoever under the laws or principles to which reference directly or indirectly has been made. Landreth Timber II further denies any conclusions or inferences which might be drawn from the selective interpretations placed upon documents referred to in the counterclaims by defendants.

### 5. *No Basis For Relief*

Landreth Timber II denies that defendants or any of them are entitled to any relief from Landreth Timber II as sought by the counterclaims on their "Prayer For Relief".

For further answer and defense to defendants' counterclaims, Landreth Timber II states:

6. Defendants have failed to state any claim upon which relief may be granted.

7. Landreth Timber II incorporates herein, as though fully set forth, the allegations contained in paragraphs 1 through 34 of its First Amended Complaint, as defenses to the counterclaims of defendants.

8. Defendants are estopped by their conduct from asserting or recovering upon the counterclaims they have asserted.

WHEREFORE, Landreth Timber II prays for judgment, in addition to the prayer for judgment contained in its First Amended Complaint, as follows:

1. That defendants' counterclaims be dismissed with prejudice and without costs to defendants;

2. That this court declare that the entire escrow fund in the possession of Seattle-First National Bank be declared to be the sole property of Landreth Timber II;

3. That Landreth Timber II be awarded its expenses, costs and reasonable attorneys' fees incurred in connection with defense against defendants' counterclaims; and

4. That Landreth Timber II be awarded such other and further relief as to the court is just.

DATED this 15th day of January, 1979.

GRAHAM & DUNN

By /s/ GERALD T. PARKS, JR.

By /s/ R. BRUCE JOHNSTON

Attorneys for Plaintiff

Landreth Timber Company, Inc.

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

Civil Action No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR.  
and KATHLEEN LANDRETH, husband and wife,  
*Defendants.*

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR.  
and KATHLEEN LANDRETH, husband and wife,  
*Counterclaim  
Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim  
Defendant.*

[Filed Aug. 7, 1980]

**PLAINTIFF'S MOTION FOR LEAVE  
TO AMEND COMPLAINT**

Pursuant to Federal Rules of Civil Procedure, Rules 15(a) and (c), the plaintiff moves to amend its Complaint as follows:

1. *The Parties.* The plaintiff moves to alter paragraphs 3, 4, and 5 to reflect that Ivan K. Landreth resides in

Redmond, Washington, and at all relevant times was married to Lucille Landreth, that Thomas E. Landreth resides in Hermosa Beach, California, and that Ivan K. Landreth, Jr., resides in Kirkland, Washington, and at all relevant times was married to Kathleen Landreth.

2. *Additional Claims.* The plaintiff moves to amend the Complaint to add the claim, at paragraphs 21 and 31, that the offer and sale of all the outstanding shares of Landreth Timber I by the defendants to the B & D Company constituted the offer and sale of unregistered securities in violation of Sections 5 and 12(1) of the Securities Act of 1933, 15 U.S.C. § 77e and 15 U.S.C. § 771(1), and in violation of Sections 21.20.140 and 21.20.430 of the Securities Act of Washington, RCW 21.20.140, .430.

3. *Grounds.* The defendants' correct current addresses and names were discovered by means of pretrial interrogatories in the above-entitled action. The additional claim arose out of the same conduct, transaction, or occurrence set forth in the original Complaint, and justice requires that all claims be adjudicated together.

DATED this 7th day of August, 1980.

EDWARDS AND BARBIERI

By /s/ John W. Hathaway  
JOHN W. HATHAWAY  
Attorneys for Plaintiff

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

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No. C78-663-R

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

vs.

IVAN K. LANDRETH and LUCILLE LANDRETH, *et al.*,  
*Defendants.*

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**DEFENDANTS' MOTION FOR  
SUMMARY JUDGMENT ON SECURITIES CLAIMS**

Defendants move for summary judgment as follows:

1. Plaintiff's federal securities claims should be dismissed because the transaction at issue in this lawsuit does not involve a security. The remainder of plaintiff's claims also should be dismissed as there is no federal jurisdiction in the absence of plaintiff's federal securities claims.

2. Even if this Court does not dismiss plaintiff's federal securities claims on the grounds requested above, it should dismiss plaintiff's federal and state claims under Sections 5 and 12(1) of the Securities Act of 1933, 15 USC § 17(e) and 77(1), and the Securities Act of Washington, RCW §§ 21.20.010 and 21.20.430, because the sale of stock at issue in this lawsuit was not a public offering and plaintiff is prevented on equitable grounds from belatedly asserting registration claims.

3. This motion is supported by defendants' Memorandum in Support of Defendants' Motion for Summary Judgment on Securities Claims and the accompanying affidavits.

DATED this ..... day of ....., 1980.

BOGLE & GATES

JAMES A. SMITH, JR.  
GUY P. MICHELSON  
PATRICIA H. CHAR  
RICHARD D. VOGT



UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

Civil Action No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
Plaintiff,

v.

IVAN K. LANDRETH and LUCILLE LANDRETH,  
husband and wife, *et al.*,  
Defendants.

[Filed Nov. 10, 1980]

**AFFIDAVIT OF SAMUEL S. DENNIS  
IN OPPOSITION TO DEFENDANTS'  
MOTION FOR SUMMARY JUDGMENT**

STATE OF MASSACHUSETTS     )  
  ) ss.  
COUNTY OF SUFFOLK         )

SAMUEL S. DENNIS 3D, being first duly sworn, on oath deposes and states:

1. I am one of the principal shareholders in the plaintiff Landreth Timber Company, Inc., and I was the principal negotiator on behalf of the purchasing group in the acquisition of all the shares of Landreth Timber Company from defendants. I make this affidavit upon personal knowledge and am competent to testify to the matters stated herein.

2. I am an attorney in the law firm of Hale and Dorr, and I reside in Newton, Massachusetts. My professional

background is primarily in the area of federal income and estate taxation. As part of my practice, I have participated in several corporate acquisitions for clients, with my primary responsibility being in the area of federal taxation. The principal investors in Landreth Timber Company shares were John Bolten and me. Prior to the acquisition of Landreth Timber Company in November, 1977, neither John Bolten nor I had any knowledge whatsoever of the forest products industry. Prior to acquisition of stock in the Landreth Timber Company, neither John Bolten nor I had ever met the defendants, Eugene Graf, their broker, Jack Branch, who worked with Mr. Graf on the transaction and later became one of the purchasers, or any of defendants' representatives.

3. I conducted all negotiations with Mr. Landreth or his representatives. Mr. Bolten was not involved in the negotiations in any way. Throughout the negotiations with Mr. Landreth, I clearly stated that the primary inducement for purchasing the shares in Landreth Timber Company was the prospect of profits to be derived from operation of the sawmill facility being designed and constructed by Mr. Landreth. No member of the purchasing group had any intention of participating in the actual operation of the sawmill facility being designed by Mr. Landreth. In completing the stock purchase, I relied solely upon the expertise of Ivan Landreth to design and construct a sawmill facility capable of generating the profits that he represented to me and to select the management personnel to operate the facility in a profitable manner.

4. I first learned of the Landreth Timber Company in late July, 1977, through a letter from Jack Branch forwarded to me by Al Willard, a local business broker. Mr. Branch's letter stated that a sawmill in Washington State was available for purchase and described the facility in detail. The letter stated that the mill specialized in lamstock, a highly profitable product; that as a small

business the mill could always obtain timber from the government; that the mill was self-sustaining, with its own logging and road-building equipment; that the owner had agreed to sell the mill four months earlier, but it had been destroyed by fire before the deal could be consummated. It further stated that the owner was using approximately \$900,000 in insurance proceeds to install a computerized facility, called a Maxi-Mill, which, with a second mill, called a Helle Mill, would radically increase the mill's productivity; that the old mill had been very profitable in the past two years, even though it had operated only a few months each year; that the new facility would produce 200,000 board feet per day and generate nearly \$7 million in annual profit. The price for the facility was \$3,300,000 plus assumption of \$250,000 in debt. True and correct copies of the Branch and Willard letters containing the above representations are attached to this affidavit as Exhibits A and B.

5. I contacted Jack Branch to obtain further information concerning the facility. Branch informed me that he was working with Gene Graf, a broker retained by Ivan Landreth, to seek a purchaser for the facility. Branch reiterated that the facility was recently destroyed by fire and that the owner was rebuilding it with new, computerized equipment that would produce much greater profits than had the previous mill. Branch added that, with the new computerized equipment, the new facility, once completed, would easily cut 200,000 board feet per day on two shifts and it would produce 100 percent overrun. Branch stated that overrun represented the amount of lumber that was produced out of a log in addition to the amount the log was scaled to produce. He stated that overrun at noncomputerized mills was around 20 percent.

6. I then contacted John Bolten, an associate and client, and related to him Branch's description of the

investment. Mr. Bolten was interested, and in late July, 1977, I asked Branch for more information.

7. On another occasion, I also spoke by telephone with defendant Ivan Landreth, who was at Branch's office. I told defendant Landreth that we wanted to purchase the operating assets and inventory of the sawmill from Landreth Timber Company. I informed Mr. Landreth that I was reluctant to purchase the corporate shares because such a purchase would render the purchasing group liable for any undisclosed corporate liabilities. Mr. Landreth was unwilling to sell the assets and replied that any sale must be structured as a stock purchase. I assumed that Mr. Landreth wanted to sell stock rather than assets in order to reduce his federal taxes on the transaction by maximizing his capital gains and avoiding depreciation recapture and receipt of ordinary income on such things as inventory. I reluctantly agreed to purchase shares if the transaction came to fruition.

8. The purchase of shares rather than assets was much more costly to the purchasing group because we were required to form a separate corporation and liquidate the corporation into the Landreth Timber Company in order to establish the proper basis for depreciation in the Landreth Timber Company assets. We incurred additional costs for the accounting work necessary to allocate the purchase price to the various assets held by the Landreth Timber Company. The bulk of these costs would not have been incurred if we could have purchased the assets directly.

9. Branch and defendant Landreth both informed me that the sawmill facility had been appraised at \$5 million to \$6 million, and that Mr. Landreth was selling the sawmill for health reasons.

10. I told Branch that the purchasing group would incur substantial expenses prior to closing the stock sale. I insisted upon an exclusive option to purchase the saw-



mill facility to protect the purchasing group in the interim. I also told Branch that we would agree to the stock purchase transaction only after we were satisfied that the new facility being designed and constructed by Mr. Landreth would be as profitable as Mr. Landreth represented.

11. Mr. Branch informed me that he believed this would be a very profitable investment and that he and a group of his associates would like to be part of the purchasing group. I agreed by letter of July 29, 1977, that Mr. Branch's group could purchase 25 percent of the stock in Landreth Timber Company and repeated that he should seek an exclusive option. Branch later informed me that defendant Landreth would not agree to an exclusive option because he was pursuing other offers. A true and correct copy of that letter is attached to this affidavit as Exhibit C.

12. We retained Peter Townsend, an accountant, to visit the construction site and review the corporation's books and records in order to verify defendant Landreth's representations. The primary reason for this review was to search for undisclosed liabilities of the corporation and to examine the strengths of internal management control. Mr. Townsend was also asked to develop cash-flow projections for the new facility. The new facility was to be radically different from the old saw-mill, and Mr. Townsend could not base his projections on past mill performance. Rather, Mr. Townsend was to rely on defendant Landreth's representations concerning productivity of the new facility.

13. Mr. Townsend sent me five reports concerning the productivity of the new facility and two reports on tax and record-keeping matters. True and correct copies of the five reports are attached to this affidavit as Exhibits D through H. I understood from the reports that defendant Landreth was the source of all information con-

cerning the profitability of the new facility under construction. The cash-flow projections based upon Mr. Landreth's representations suggested that the new facility under construction would be very profitable.

14. The August 9 report stated that Mr. Landreth projected \$700,000 profit for 1977 if the old mill had not burned down. From discussions with Mr. Landreth, Mr. Townsend projected annual profits of at least \$1,000,000 from the new facility. The September 15 cash-flow projections were prepared after a two-day visit with Mr. Landreth and Pat Peyton, his accountant. The September 15 report projected a net profit of over \$1,000,000 during the first year of operations from a one-shift operation. The report stated that the Maxi-Mill would be operational on November 1, 1977, and fully efficient by January 31, 1978. The Helle Mill was to be operational by October 1, 1977, and fully efficient by October 15. The September 15 report stated that Mr. Landreth's conservative estimate of timber mix for the new facility included 52 percent lamstock production and another 20 percent of highly profitable clears and framing lumber.

15. On September 29 and 30, Mr. Townsend visited the construction site and discussed with Mr. Landreth internal control matters and status of construction. His October 14 report stated that no sales, costs or expense records were available because Mr. Landreth was so close to mill operation that none were prepared. Mr. Townsend, in his November 4 report, stated that, on September 30, Mr. Landreth stated that \$164,000 in capital expenditures remained to be made. The cash-flow projection stated that first-year net profits would exceed \$1,600,000 on a double-shift basis. Mr. Townsend's November 16 report stated that Mr. Landreth had provided a figure of \$136,789 in capital expenditures remaining to complete construction.

16. Mr. Landreth's representations to me directly, and as reported by Townsend concerning the profits of the



new facility and his agreement to remain after closing to help manage the operation constituted the primary inducements for me to enter into this transaction. Mr. Landreth's assurances that the facility was nearly completed induced me to close the transaction on November 17, 1977.

17. Mr. Branch furnished me with a July 29, 1977 report from Lease & Beadling Engineers, Inc., concerning the equipment that would make up the new sawmill facility. The information contained in the report was based on one visit to the mill and some interviews with Mr. Landreth and his equipment suppliers. The report did not attempt to estimate the actual replacement value of the equipment then at the plant, but rather estimated what the capital cost would be to establish a new mill with the equivalent capacity and efficiency represented by Mr. Landreth. The report estimated that it would cost between \$3 million and \$3.5 million to construct a sawmill capable of producing 200,000 board feet per shift on a two-shift basis. I felt that I could put very little weight on the Pease & Beadling preliminary appraisal of the value of the facility because the sawmill was still under construction.

18. I visited the Landreth construction site on September 15, 1977. At that time, construction of the computerized Maxi-Mill had not yet begun. Only a concrete floor was in place where the computerized mill was to be installed. The existing facilities that had survived the fire were intact. The Pease report had criticized some of these facilities, especially the smaller Helle Mill, which was not operating, the debarking facilities, and the dry kiln. Ivan Landreth disagreed with these criticisms and informed me that the Helle Mill was a top-flight piece of equipment suited for the job. He stated that the planer was old, but worked well and it was serviceable, and that the dry kiln was reasonably new and serviceable. I specifically informed Mr. Landreth that, to justify

the investment, the mill would have to be operated on two shifts. Mr. Landreth informed me that the mill could operate on two shifts after the Maxi-Mill had been started, and that it ought to produce 200,000 board feet per day on a two-shift basis. Mr. Landreth stated that the noncomputerized Helle Mill portion could go on a two-shift basis almost immediately, and that the computerized portion could be operated on two shifts after three months start-up. Mr. Landreth had kept his key personnel including his plant manager who had been with him for many years and assured me that they were competent, experienced and could run the new operation on a two-shift basis satisfactorily. He also stated that there was adequate labor supply in the Tonasket area. Mr. Landreth took me on a tour of the construction site and assured me that all the facilities were in good condition and suitable for their purposes. During that meeting, I informed Mr. Landreth that I was relying on him for the facts concerning the quality and capacity of the sawmill components because the facility was only half constructed and was not running. Landreth assured me that the equipment was in good operating condition and would only need routine maintenance, and that the production of 200,000 board feet of lumber per day could be achieved with the equipment then at the plant, once the computerized portion was completed.

19. I asked Mr. Landreth to continue on as general manager of the sawmill facility after the purchase and to be a member of the board of directors of the new corporation. I explained that his knowledge of the design of the facility and of the management structure and market for the products was essential to insure the profitability of the investment, especially since the purchasers had neither the expertise nor the intention to actually operate the mill. Mr. Landreth informed me that he would prefer not to be in direct charge of managing the facility or serve on the board of directors. I told Mr. Landreth that we could not complete the transaction unless he was

willing to service full-time in a management capacity for at least (sic) the first six months and then stay on as a consultant. I also asked him to work with Branch to find a suitable manager. Mr. Landreth and the purchasing group eventually entered into a consulting agreement under which Landreth agreed to stay on full-time for the first year. A true and correct copy of the consulting agreement is attached to this affidavit as Exhibit I.

20. Defendant Landreth and I agreed on a purchase price of \$3 million, plus assumption of the bank debt, which now totaled \$400,000, all cash at closing. The transaction was jointly financed by Rainier National Bank and The First National Bank of Boston, which agreed to loan the purchasing group \$1.9 million, secured by a first mortgage on the plant and equipment, plus \$1.5 million in loans guaranteed by Mr. Bolten and me and secured by \$530,000 cash on deposit and marketable securities owned by Mr. Bolten and me in Standex International Corporation. By the terms of the Amended Stock Purchase Agreement, the defendants were paid \$750,000 at closing, with the balance of \$2,250,000 to be paid by the bank on January 10, 1978. An escrow account of \$150,000 was first set aside and later increased to \$300,000.

21. The closing documents include a Stock Purchase Agreement, executed on October 6, 1977, an Assignment of, and Amendment to, the Stock Purchase Agreement, executed November 16, 1977, a Certificate executed on November 17, 1977, stating that defendants' warranties and representations in the October 6, Stock Purchase Agreement were true and correct as of November 17, 1977, and an opinion by Mr. Landreth's attorney, Edward Engst, that the corporation was duly incorporated, that all shares were duly and validly issued, and that there were no restrictions on transfer imposed by the articles of incorporation or bylaws, and that the transfer of all the issued and outstanding shares would not con-

stitute a violation of any statute or regulation. True and correct copies of these documents are attached to this affidavit as Exhibits J through M. The Stock Purchase Agreement and other closing documents underwent several changes during the negotiations. Drafts of all these documents were forwarded to Edward Engst, defendant Landreth's attorney, throughout these negotiations.

22. Mr. Landreth was present at closing with his attorney, Edward Engst. The closing documents contained warranties concerning the quality of mill equipment and the production capacity of the facility. Mr. Landreth also warranted that the physical assets of the company consisted of an integrated lumber manufacturing facility in Tonasket, Washington, constructed with first-quality and suitable equipment in a workmanlike manner. The closing documents warranted that the cost to complete the construction would be approximately \$136,000, and that the construction would be completed by the end of November, 1977.

23. At the closing, I again told Mr. Landreth that I was relying upon him for the construction figures and the production capacity of the mill. I told him that I would not rely upon appraisers or accountants because I was purchasing Landreth Timber Company from Ivan Landreth, and not from the appraisers and accountants. Mr. Landreth reiterated his statement that the mill would produce 100,000 board feet per shift and that the \$136,000 figure to complete construction was correct. I executed the closing documents on behalf of the purchasing group in reliance upon Landreth's representations and warranties. After closing, the shareholders in the Landreth Timber Company included John Bolten and myself as owners of all Class A shares. The Class B shares, representing 15 percent of the equity of the corporation, were held by Jack Branch, Al and Isabel Willard, Troy N. Beaver, Jr., and Robert E. Branch.



24. Shortly after closing, Philip Cook, the new general manager, informed me that construction was far behind schedule. I directed Mr. Cook to segregate expenditures relating to mill construction and to keep a running account of construction costs. We hired Al McKimmey, an experienced sawmill accountant, to review the cost overrun and to organize the figures in the event that they would need to be asserted as a claim against the escrow.

25. The major problem to complete the mill was construction of the computerized Maxi-Mill. Actual construction of this had not yet begun. Only the concrete substructure was in place. The manufacturer, Warren & Brewster, informed us that Mr. Landreth had refused a proposal by which Warren & Brewster would perform all the engineering, fabrication, and construction work on this facility. Mr. Landreth had purchased only the Maxi-Mill itself. No engineering had been performed for the conveyors and other equipment that would integrate the Maxi-Mill into the rest of the facility. No provision had been made for fabrication of this equipment. On November 19, 1977, Lyle Warren, the president of Warren & Brewster, flew to the construction site with Warren & Brewster personnel to inspect the problems. They concurred that it would take months to finish construction and recommended that Almax, a subsidiary of Warren & Brewster, be hired to finish construction. Almax began work on November 20, and, using mill personnel as well, worked for a period of eight weeks, including substantial overtime, to complete the Maxi-Mill construction.

26. Mr. Landreth was either absent or unhelpful in aiding us in seeking solutions to the construction problems. When it became apparent that Mr. Landreth was not cooperating in solving these problems and that we would need to assert a claim against the sellers for these

cost overruns, we terminated Mr. Landreth's consulting contract. On January 4, 1978, a claim for overruns to that date were served on Edward Engst, Mr. Landreth's attorney. On January 10, 1978, the escrow amount was raised to \$300,000 to cover the claim for additional Maxi-Mill construction costs. The remainder of the purchase price, \$2,100,000, was disbursed by the bank to sellers.

27. Exhibit H to the Amended Stock Purchase Agreement stated that the sawmill construction could be completed for \$5,000 during a two-week period through November 30, 1977. The actual labor required to complete just the computerized portion of the sawmill totaled \$89,740 and took over eight weeks, even though the construction was being handled by personnel who were skilled in the installation of this particular machinery. Mr. Landreth warranted in the closing documents that payments to the manufacturer of the Maxi-Mill (the computerized portion of the facility) to complete construction would total \$72,000. The actual total paid to this company to complete the Maxi-Mill installation was over \$150,000. These payments were for parts to the Maxi-Mill system that were necessary for the operation of the sawmill. In addition to the sawmill construction costs incurred after November 17, 1977, there were nearly \$30,000 in invoices relating to equipment that had been purchased, but not paid for, prior to closing. The portion of these items incurred before January 4, 1978, formed the basis of the claim then asserted against sellers.

28. Throughout December and January, the efforts of sawmill personnel were directed toward completion of the Maxi-Mill. This facility was completed in early February, 1978. During the initial testing of the Maxi-Mill in February, we realized that other major pieces of the mill were defective and totally inadequate. The edger installed by Mr. Landreth was incapable of functioning



because no set works could be designed to operate it, and it had to be replaced at a cost of over \$50,000. The debarking facility was completely worn out and totally inadequate to supply logs to the mill. It repeatedly failed to debark logs, causing the computerized Maxi-Mill to malfunction. Mill personnel informed us that Mr. Landreth had to run the debarker on double shifts to keep up with the capacity of the old mill. Consequently, it was clear that a new debarker would be necessary. Because total expenditures on mill construction had by then reached over \$250,000, the purchasing group did not have sufficient funds available to buy a new, fully adequate debarker. A used debarker was purchased and installed for \$27,000.

29. The largest amount expended in completing the sawmill facility was for a substantial number of items necessary to complete noncomputerized portions of the facility. Nearly \$235,000 was paid for such items as electrical equipment, transportation of materials, computer programming, labor, welding equipment, and machine work.

30. In total, the actual cash outlays expended on mill construction and equipment exceeded the amount warranted by Mr. Landreth in the Amended Stock Purchase Agreement by over \$500,000.

31. The above expenses for mill construction were paid by the corporation. From closing on November 17, 1977, until the transfer of the assets to the Tonasket Timber Company on October 5, 1978, the sawmill facility was never fully operational. Only insignificant production was generated. The mill never produced even a fraction of the warranted production of 100,000 board feet per shift for more than a few hours at a time. We achieved insignificant overrun. The bulk of labor costs continued to be on construction items. In addition, the equipment in the Landreth mill proved in-

compatible with the production of lamstock, which must be produced under precise conditions. The old fire-fed dry kiln was incapable of moisture controls sufficient to dry the lamstock to the required moisture content, and the manufacturing equipment lacked the precision to produce even a small quantity of acceptable lamstock. The production that was achieved was of only low-grade lumber.

32. Further problems were caused by Mr. Landreth's serious design errors in constructing the facility. The building housing the facility was so small that all major pieces of equipment were crowded for space. Consequently, any minor malfunction caused the entire facility to shut down. In July, 1978, my attorneys sought advice from Harry Kennison, a sawmill engineer, in connection with these claims. Mr. Kennison concluded that we would have to completely redesign the layout of the mill to improve production.

33. During this period, the Rainier National Bank advanced an additional \$800,000 to the corporation to finance the cash-flow deficit. This raised the amount subject to Mr. Bolten's and my personal guarantee to \$1.9 million in addition to the \$530,000 cash on deposit which had been consumed. In addition, Mr. Bolten and I personally advanced over \$635,000 to the corporation to help finance the cash-flow deficit. By July, 1978, the corporation's financial statement showed a loss of over \$1.7 million. These losses, plus the capitalized portion of the cost of completion, total over \$2 million. These losses continued until the assets were transferred to the Tonasket Timber Company.

34. In July, 1978, it was apparent that Mr. Bolten and I could no longer continue to pay for the losses and cash-flow deficits of the corporation. The corporation was faced with either bankruptcy and liquidation or seeking a purchaser for the sawmill. As Mr. Bolten and

I would continue to be liable on our guarantees to Rainier National Bank, we sought a purchaser for the assets rather than liquidation. After considerable search, only Tonasket Timber Company was willing to take over the facility. Tonasket Timber Company agreed to expend an additional \$500,000 on capital improvements. The banks permitted the transfer only on the condition that the corporation remain liable on the bank loans and that Mr. Bolten and I remain liable on our guarantees. In addition, Mr. Bolten and I were required to pay down the bank debt and to pay certain corporate creditors. Our cash outlays to effect the transfer totaled \$1,035,000. Neither Mr. Bolten, the corporation nor I received any payment whatsoever from Tonasket Timber Company. As Mr. Bolten and I could no longer sustain the corporation losses, we were compelled to accept the offer. On October 5, 1978, the facility was transferred to Tonasket Timber Company. On November 1, 1978, this lawsuit was filed. In November, 1979, I was notified by Rainier National Bank that the bank was foreclosing on our guarantee and on the Tonasket Timber Company because the Tonasket Timber Company had defaulted on our loan payments. In January, 1980, at a sheriff's sale, the sawmill facility was sold by the Rainier National Bank for approximately \$600,000.

35. Mr. Bolten's and my actual cash losses as a result of the sellers' misrepresentations as to the capacity and quality of the facility and sellers' failure to disclose the true state of construction and defects in equipment total over \$3,400,000. The losses consist of the following amounts:

Rainier Bank loan guarantee	\$1,725,000
Stock purchase	170,000
Operating loan	530,000
Advances for operating losses	635,000
Payments to corporate creditors	220,500
Commission on sale to Tonasket Timber	95,000
Payroll taxes	50,000

I was required to sell a major portion of the property I own to cover these losses. In June, 1980, Mr. Bolten and I paid Rainier National Bank \$1,025,000, the remaining balance on our guarantee.

Aside from purely financial losses, as devastating to Mr. Bolten and me as they have been, one cannot over-emphasize the injury to Mr. Bolten's health that has been caused by this transaction. In February, 1978, I and Mr. Bolten, who is an elderly person, visited the construction site to confer with management concerning the state of construction. Mr. Bolten was visibly shaken by the deep problems we encountered, and, shortly thereafter, he suffered a massive heart attack, from which he has never adequately recovered.

/s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3d

SUBSCRIBED AND SWORN to before me this 6th day of November, 1980.

/s/ Ruth A. Weymouth  
Notary Public in and for the  
State of Massachusetts, re-  
siding at Framingham, MA  
01701

My comm. expires Dec. 21,  
1980.

D/2361B

## EXHIBIT A

AL WILLARD  
3 Windy Hill Road  
Cohasset, Mass. 02029  
617-303-0197

July 21, 1977

Mr. Samuel Dennis, 3d  
Hale & Dorr  
28 State Street  
Boston, Mass. 02108

Dear Sam:

The enclosed "Landreth Lumber Mill" is a financial situation that deserves your attention. Jack Branch and I would like to take control of the situation, and would be guided by your expert advise. The money situation (\$3,300,000) could be a tremendous obstacle, and I would appreciate your comment.

Sincerely,

/s/ Al  
AL WILLARD

AW/pc

PS: I am purposely not bothering you regarding the Astrodome. Needless to say I do expect to fulfill my role in naming the Chairman of the Board, and if I do, Sam Dennis and Al Willard will receive stock in the corporation, and, Hale and Dorr (with their consent) will still be the legal consultants.

## EXHIBIT B

TIMBER WEST, INC.

July 19, 1977

Mr. Al Willard  
3 Windy Hill Road  
Cohasset, Mass. 02025

Re: Landreth Lumber Mill, Tonasket, Washington

Dear Al:

Attached are the preliminary work sheets on the mill I mentioned to you in Washington State. This is in the Okanogan National Forest area of north central Washington in an area that cuts approximately 250 million bd. ft. of timber per year (150 mile radius). This particular area is especially noted for a product known as lamstock; more especially, this timber is slow growth, fine grain and is used and in demand in making laminated beams and other laminated wood products. This is quite slow growth douglas fir (80%) and ponderosa pine (20%).

The mill has purchased 30 million bd. ft. of timber from SBA Forest Sales (SBA Forest Sales are sold only to small mills). Twenty-five percent of sales of the Okanogan National Forest are set aside for SBA Sales and 45% of the sales from Colville National Forest are set aside for SBA sales.

The average stumpage from these sales runs between \$60 and \$100 per 1,000 according to a government timber index code. Presently, the stumpage is approximately \$80 and appears to be steady. One recent sale this year was 6 million bd. ft. at \$81 and another 11 million bd. ft. at \$86 per 1,000.

The mill was destroyed by fire approximately 2 months ago and a new maxi-mill, all computerized with new



graphite band saws, is being built and will be completed by the end of September at the latest. This new maxi-mill cuts an over-run of 100% of the standard Scribner scale of measuring logs (logs are scaled from the smallest end and a certain inch log has a pre-determined scale of board feet according to a scale book set forth about 50 years ago).

Most of the old time mills cut 20% to 25% over-runs. Example: if on the log scale, the log had 1,000 ft. in it, it would cut from 1200 to 1250 ft. when run through the saw mill. With this new computerized maxi-mill, the log would yield approximately 1,000 ft. where you were only scaled at 1,000 ft. We pay stumpage and logging on scale only. The over-run of 1,000 bd. ft. has only the mill cost of \$30.00 per 1,000 bd. ft. to be taken from the sale. The balance is net profit.

The logs enter the mill on a conveyor and go through a debarker which literally skins them like a telephone pole. It then goes to the chipper which routs (chips) out the outside part to make the log square. In other words, the new mill does not cut off slabs; it turns all of what used to be slabs from the side of the log into pulverized chips that are sent to a paper mill for paper products. In this particular case, the mill has a contract with Weyerhaeuser in Longview, Washington and ships all of the chips produced at approximately \$30 per cunit profit. A cunit is a unit of measurement in timber (approximately 600 bd. ft.) measured by volume weight.

The mill has a kiln dryer with a dutch oven (waste burner to burn the sawdust). The kiln drying system has the capacity for 100,000 bd. ft. per day. This timber takes two days in the dryer so we will have to increase the kiln drying capacity to 400,000 bd. ft. per day to cover two shifts of production. This cost is estimated to be \$200,000.00. There is adequate space for this expansion.

This mill is unique in that it does not buy from any outside loggers and the operation has all the logging and road building equipment to be self-sustaining.

The owner of the mill is very eccentric and since he is his own supplier, merely runs the mill when he wishes to. The books show for nine months of operation in 1974 the profit before taxes was in excess of 1.1 million dollars of which \$450,000 was paid in taxes. In 1975, profit was \$400,000 from only 4 months of operation and in 1976, \$300,000 from 3 months of operation. The man's wife was ill and was frequently in California for X-ray treatments and he simply closed the mill down.

The man agreed to sell the mill approximately four months ago and before anything concrete was put together, the mill burned down and insurance is paying for the complete new maxi-mill (approximately \$900,000 worth of installation). Some of the old equipment was salvaged, but not much.

There is 1.5 million bd. ft. of logs in the yard at present, paid for at an estimated cost of \$80.00 stumpage and \$50.000 logging (\$195,000). There is 1.5 million bd. ft. of logs decked in the woods (logging cost of \$50.00 is paid for—\$75,000 value). Stumpage is paid for after the logs are delivered to the yard and they are scaled by the Forest Service.

There is 1 to 1½ million bd. ft. of cut kiln dried lumber in inventory in the storage sheds and in the yard. This is stock to ship from and it takes approximately this much inventory to maintain shipments. The wholesale value of this lumber would be \$160 per 1,000 or between \$160,000 and \$240,00. The new maxi-mill would easily cut 200,000 bd. ft. per day (two shifts) at a profit of \$145 per 1,000 including the 100% over-run (set work sheet attached).

At 200,000 bd. ft. per day and \$145 per 1,000 profit, this equals \$29,000 per day, \$580,000 per month, \$6,900,000 per year profit.

This mill is listed at \$3.3 million with an assumption of a \$250,000 note plus an anticipated \$200,000 addition to the kiln dryer and an \$250,000 operational reserve for a total of \$4 million. The terms are cash and it will take a \$200,000 deposit to inspect the books and arrange closing in approximately 30 days. This mill is a very good buy and should fit the tax situation we discussed. We have a place to handle the financing, but I would like your comments and appraisal of this situation if you are interested. Let's pursue this further by phone after you have reviewed these materials.

Respectfully yours,

TIMBER WEST, INC.

/s/ Jack P. Branch  
JACK P. BRANCH  
President

JPB:jmk  
Enc.

## ASSETS—LANDRETH MILL

LAND VALUE (70 acres at \$3,000 per acre)	210,000
Replacement Cost (mill & planer incl. bldgs.)	1,200,000
Kiln Dryer (including dutch oven)	500,000
Rolling stock (yard, logging & road bldg. equip.)	350,000
* 30 million bd. ft. of timber (on contract from U.S. Forest Service bought but not paid for)	
Logs down in woods (1.5 million at \$50.00 per 1,000 bd. ft. logging pd.)	75,000
Log inventory 1.5 mil in yard (at \$80.00 per 1,000 + \$50 logging cost)	195,000
Deposits & Credits	50,000
Lumber inventory & accounts receivable (approximately \$100,000)	250,000
Cash in Bank (approximately)	150,000
	<u>\$2,980,000</u>

NOTE PAYABLE: \$250,000 SBA Loan

TOTAL PRICE: 3.3 million dollars CASH plus payment or assumption of SBA loan.

\* A bond is placed with the Forest Service to guarantee payment, thus cutting down the cash needs of timber purchase.

LANDRETH MILL  
Tonasket, Washington

Average Sales Price		\$240.00 per 1,000 bd.
Stumpage	\$80.00	
Logging	50.00	
Milling	30.00	160.000
		<hr/>
		\$ 80.00 Profit

At 20% over-run the mill would have cut 1200 bd. ft. from this 1,000 bd. ft. from scale. This would give us 200 bd. ft. extra and on a pro-rata basis would raise the \$80.00 profit to \$122.00. (20% of \$240=\$48.00 less 20% of \$30.00 milling fee or \$42.00+\$80.00=\$122.00 profit per 1,000 bd. ft.—old mill production).

With the new maxi-mill, the over-run would be 1,000 bd. ft. extra and the only cost against that would be the \$30.00 mill cost.  $\$80.00 + \$210.00 = \$290.00$  on 2,000 bd. ft. or \$145.00 per 1,000 bd. ft. net profit (before tax).

With the availability of government SBA Sales, we will have no problem keeping this mill in timber forever. We would be able to repay the investment within 15 months from funding or work out any royalty situation favorable to taxes.

## EXHIBIT C

HALE AND DORR  
ORIGINAL FILE COPY  
Not to Leave the Office

July 29, 1977

Jack P. Branch, Esq.  
Timber West, Inc.  
300—220th St. N.E.  
Building 3, Suite 200  
Bellevue, Washington 98005

Dear Jack:

This will confirm our conversations today relative to the exclusive option which you are endeavoring to obtain from Mr. Ivan Landreth for the acquisition of Landreth Timber Company, Tonasket, Washington.

As we have discussed, I have arranged for Mr. Landreth or his representative to call Mr. Peter Read, Senior Vice President for the First National Bank of Boston, who will assure him as to my financial capability in connection with the financing of the acquisition of this timber company. It is agreed that you may have the option run to Timber West, Inc., your company, subject to a provision in the option agreement that all rights and obligations under the option may be assigned and transferred to a new corporation to be formed to acquire the timber company. In the event that such acquisition occurs, the capitalization of which will be structured so that my investing group will have their equity investment paid out first with the balance of the corporation equity owned 75% by this group and 25% by you and your group. Pending formation of this corporation the beneficial owners of the option shall be 75% myself and my nominees and 25% Timber West, Inc. and its nominees.



When an irrevocable option has been obtained in form satisfactory to me, I understand that you will immediately undertake to have all aspects of this business evaluated by objective experts (including financial, operating, availability of timber, and marketing considerations) and furnish such information to me. If satisfied that we should go ahead, I will then devote my best efforts to obtaining the necessary financing.

I am enclosing a copy of this letter for your approval and return if the above is satisfactory and in accordance with your understanding.

I am looking forward to working with you.

Sincerely,

S. S. DENNIS, 3d  
7/29/77

Enclosure

The above arrangements are hereby approved.

JACK P. BRANCH  
TIMBER WEST, INC.

By: \_\_\_\_\_

CC: Mr. Willard

EXHIBIT D

PETER H. TOWNSEND

[Address Omitted]

August 9, 1977

Mr. Jack Branch, President  
Marting Logging, Inc.  
Building 3  
Benaroya Business Park  
Bellevue, WA

Re: Landreth Timber Co., Inc. (the corporation)

Dear Mr. Branch,

After a meeting with you and Mr. Ivan Landreth (president of the corporation) in your office on Wednesday, August 3 it was decided that I would visit Mr. Pat Peyton, CPA (of the corporation's CPA firm in Wenatchee, WA), and then visit with Mr. Landreth at the corporation's mill in Tonasket, WA. It was agreed that the purpose of the visit would be to get as much additional information as possible on the corporation within the confines of a one day visit.

This report in no way constitutes an audit report, as no auditing was conducted nor may it be used in any offering where state or federal securities registration is required. It is suggested that if an offer is made to purchase the stock or assets of the operation, then a pre-acquisition audit should be made to ensure that the corporation does in fact own the stated assets and that there are no additional liabilities. Also, it is recommended that detailed pre-acquisition profit plans and cash flow projections be drawn up for a 5 year period.

## A. VISIT TO CPA

I visited Mr. Peyton in Wenatchee on Friday, August 5.

### A-1. INCOME TAX

I reviewed the corporation's income tax returns for 1973-1976. Each year is a voluminous package and contains a report from a Seattle consulting forester to substantiate fair market value of timber in the contracts with the U.S. Forest service. Mr. Peyton said that he had some 6 years experience in Touche Ross and Co.'s (one of the Big 8 accounting firms) Seattle office in the tax department and he seemed knowledgeable on the corporation's tax and business affairs. He showed me the 1973, 1974, and 1975 IRS audit adjustments of some \$25,500. This was a minimal adjustment (mainly for disallowance of investment credit, capital gain and inventory matters) when related to the \$419,000 income taxes provided for in the financial statements for these years. The income tax returns were reconciled to the unaudited financial statements.

### A-2. MINUTE BOOK

I reviewed the corporate minute book which contained no items for 1975, 1976 and 1977. These confirmed Mr. Landreth's salary of \$60,000 per year plus 10% of the corporate profit before income tax; Mrs. Landreth receives \$5,000 annual salary. Also mentioned were the 1974 nationwide business recession and material reduction in housing starts and the effect on lumber sales, volume and price. As of January 6, 1977, Mr. Landreth owns 380 shares and his two sons each own 120 shares, making 500 shares total.

### A-3. 1977 FINANCIAL STATEMENTS

Unaudited financial statements for the 6 months ended June 30, 1977 should be available by August 19, 1977—

initial results produced by the corporation's bookkeeper show an approximate break-even for the 1st quarter of 1977 and a \$76,000 loss for the 2nd quarter 1977. This has been financed by a 1976 tax refund of \$149,726 (higher than estimated at 12/31/76.)

### A-4. INCOME TAX HANDLING OF ACQUISITION

It is highly likely that Mr. Landreth and his sons will only sell the stock in the corporation in order for them to gain maximum capital gain treatment. In order for the purchaser to gain maximum value for the corporate depreciable assets (equipment, vehicles and buildings) it would probably be necessary for a corporation to acquire the stock of Landreth Timber Co. and then to simultaneously liquidate this stock under Section 334(b) of the Internal Revenue Code. Under this method the purchase price could be allocated to the equipment, vehicles and buildings at close to appraised or fair market values, and thus increasing the annual depreciation charge against the profits.

### A-5. FINANCIAL RESULTS 1973-1976—SEE ATTACHMENT I

## B. VISIT TO MR. LANDRETH

### B-1. GENERAL OPERATIONS

Mr. Landreth gave the following information to me on Saturday, August 6 which I did not verify:

The corporation is engaged in logging, processing and selling fir and larch framing lumber and lamstock (for laminations). Mr. Landreth did not have any analysis of the largest customers by volume for any given year—however, this information could be obtained. There is a good sales analysis by type of product sold for each year. The timber is all situated within 16-40 miles of the mill at Tonasket, WA. There are presently five supply con-



tracts with the U.S. Forest Service—2 contracts with some 6 million remaining board feet expire in 1978 and 4 contracts with some 25 million remaining board feet expire in 1980. Mr. Landreth has in the past always cut his contract amount—if he could not process it, the logs could be sold to other mills. Mr. Landreth had at December 31, 1976 deposits of some \$24,000 with the U.S. Forest Service against his performance on the contracts. In addition, he said that there is \$50,000-\$100,000 in road credits due the corporation for reimbursable road costs which he has incurred on U.S. Forest Service land—these are not shown on the books at present. Mr. Landreth indicated that with the small business set aside by the U.S. Forest Service and as there were usually only 2 or 3 bidders including himself for the small business portion, he had not had difficulty in maintaining a reliable source of supply. There is one other S.B.A. mill and competitor in Oroville, 20 miles to the north. The price paid for logs is based on the increase or decrease of the Western Wood Products Association index against the index on the contract signature date. If the index goes up, the purchase price increases by half the amount of the increase. If the index decreases, then the purchase price decreases by the full amount of the decrease. Mr. Landreth said that he has guaranteed performance of the contracts personally, so that the corporation has avoided paying large advance stumpage costs. You would have to ascertain whether this arrangement could be continued or what the advance stumpage costs would be in relation to the cutting volume which you are considering.

On the selling side, Mr. Landreth said that his product is a commodity subject to supply and demand; this applies to the framing lumber and to a lesser extent on lamstock. Freight out is paid for by customers. More lumber is going by truck now, although a fair amount leaves by the Burlington Northern railroad which is approximately  $\frac{1}{2}$  mile away.

The 70+ acres of company owned land—part is used partly for the mill, partly for sawdust storage for resale and the greater part is not used. There is  $\frac{1}{2}$  mile of paved road frontage. Mr. Landreth is uncertain of zoning—however, he assumes that with a grandfather clause, the land would be industrial. Some of the land would be unusable as it is hilly. There is no growing timber on the land.

## *B-2. RECENT HISTORY*

1973 was the best year for operating results with 9-10 months operations possible when profits were good.

1974—in January there was a kiln fire which stopped production for 5-6 months. The previous kiln was replaced by a modern brick and steel structure.

1975—equipment and buildings showed capital expenditures of \$144,000 and Mr. Landreth estimated that there was a similar amount expensed. Operations were closed for 6 months thru June 1975 to install the debarker, surge bin, shaker screen, vibrating conveyor, edging chipper, and 2 head rig chippers.

1976—the mill was closed from April 1976 thru February 1977 due to personal problems regarding Mrs. Landreth's health.

1977—in early May there was a mill fire and production has been curtailed since. The mill is being rebuilt from insurance proceeds of some \$700,000. Mr. Landreth indicates that maybe \$750,000-\$800,000 will be spent on the replacement equipment. Mr. Landreth estimates that the Helle Mill will be operational by mid-September and the Maxi Mill sometime in October.

Mr. Landreth has estimated that if production had not been interrupted in 1974-1977 as indicated, then at least \$700,000 profit before taxes would have been achievable using the 1973 existing equipment.



### B-3. NEW OPERATION

The slab of the new mill building is poured—a new steel STRAN building has been ordered—70' x 170' with an additional 40' x 40' WING. There will be no posts inside the building in the working area. Mr. Landreth expects the annual insurance charge to drop from about \$65,000 to about \$45,000. The new equipment will produce a far greater over-run and use fewer operators than the burned out mill.

Most of the fuel for the kiln is provided from sawdust. The corporation is selling wood chips for paper manufacture as a by-product.

### B-4. OTHER FINANCIAL INFORMATION

In 1972-1976 bad debts did not total more than \$25,000. Payment terms to customers are 2% for 10 days EOM. Mr. Landreth estimated that 70% of customers accepted these terms.

Mr. Landreth has mentioned that up to \$500,000 in cash might be needed for working capital. In addition to the SBA loan with Old National Bank of approximately \$250,000 which is now due for renewal, the corporation is presently borrowing approximately \$120,000 from Mid Valley Bank, Omak, on a short-term basis. Under the SBA program, Mr. Landreth mentioned that up to \$550,000 would be available as a ceiling in refinancing the existing loan. At August 7, 1977 there was \$35,070 in the general bank account and \$451,534+ interest in the savings account (insurance proceeds not yet re-invested in new plant and equipment.)

### B-5. PERSONNEL INFORMATION

There is no union shop. Average wages are \$5.00 to \$8.00 per hour for hourly personnel and there is no paid vacation for them. Foremen and superintendents are

paid from \$1350 to \$1750 per month. A general manager to handle marketing and all other mill responsibilities would cost from \$30,000 to \$40,000 per year. Mr. Landreth mentioned Manhill Personnel in Portland, Oregon as specializing in this field along with other firms. For salaried personnel there is 1 week vacation after 1 year and 2 weeks after 3 years. There is a health insurance plan paid for by the corporation for its employees—dependents are also covered if the employee pays for this cost. There is also a group life insurance plan in effect. Industrial insurance is provided by the corporation through the compulsory Washington State plan. At present, one worker has a claim in process for a crushed thumb.

### B-6. BOOKS OF ACCOUNT

These are maintained manually in Tonasket and the outside CPAs produce quarterly unaudited financial statements. I did not do any auditing work although the 1977 books which I saw (check register, sales journal, accounts receivable ledger and payroll journal) appeared to be well maintained. With a larger volume of sales and production, some mechanization could be considered —this could also cover inventory control.

### C. CONCLUSION

You mentioned that your machinery, equipment, and plant and vehicle approval would be at least \$4 million based on a qualified appraiser's report. You mentioned that the asking price is \$3,500,000 less any short or long-term debt. You and Mr. Landreth have indicated that the new mill will be substantially more profitable than the previous one.

Without making or having any detailed projections, and based on conversations with you and Mr. Landreth, it is assumed that after tax profits of at least \$1 mil-

lion annually would be achievable (see attachment II). This should pay off in 4 years the \$3 million plus say \$600,000 of possible needed operating capital. I believe that before finalizing the proposed acquisition you should draw up a 5 year profit and cash flow projection on a low, medium and high basis taking into account the new mode of operation. In addition, I believe that you should get any necessary assurances that the computerized mill will produce the over-run claimed for it—preferably making this a condition of the purchase contract. Also, I believe that there should be verification of the corporation's assets and liabilities as of the date of purchase (or as of June 30, 1977) and that there should be some audit work performed on one of two years' results before finalizing the contract. The purchase agreement should also provide for who should pay for the audit work, and also for an amount to be set aside in escrow in case of subsequent IRS adjustments or other unstated liabilities.

Subject to the foregoing pre-acquisition feasibility work and other items which I have mentioned and subject to the necessary skilled legal assistance in drafting the agreement, the purchase appears to offer a more than reasonable return on the capital invested.

Very truly yours,

/s/ Peter H. Townsend  
PETER H. TOWNSEND

Attachments (2)

Unaudited sales, expenses and profits per the  
corporation's unaudited financial statements

	1976	1975	1974	1973
NET SALES AND MISC. INCOME	1,016,530	1,324,460	1,489,354	2,578,153
COST OF LUMBER SOLD	1,181,958	1,388,046	1,144,766	1,702,848
GROSS PROFIT (LOSS)	(165,428)	(63,586)	344,588	875,305
ADMIN. AND SHIPPING EXPENSES	113,795	119,701	174,270	134,385
NET PROFIT (LOSS) BEFORE INCOME TAX	(279,223)	(183,287)	170,318	740,920
PROVISION FOR FEDERAL INCOME TAX EXPENSE/ (REFUND)	(134,000)	(99,805)	72,964	346,015
NET PROFIT (LOSS)	(145,223)	(83,482)	97,354	394,905
EARNINGS PER SHARE	(290.45)	(166.96)	194.71	789.81

Includes salary for Mr. and  
Mrs. Landreth of:

\$ 65,000 \$ 65,000 \$ 102,500 \$ 117,500

1972 showed a net profit before tax of \$378,407 (including 72,769 profit on  
repayment of notes)

1971 showed a net loss before tax of \$22,047

1970 showed a net loss before tax of \$107,793

1969 showed a net loss before tax of \$52,689

1968 showed a net loss before tax of \$3,608

**TENTATIVE UNAUDITED PROJECTION OF  
INCOME STATEMENTS BASED ON 1973 PROFITS**

Taking 1973, the last full year of production and sales, as a base year when 12 million board feet were sold with a pre-tax profit of \$740,920, the following assumptions would appear to be reasonable. Since 1973 vastly improved plant and equipment has been or will be installed. Diesel fuel has largely been replaced by sawdust to heat the new kiln. A new mill will have been installed by October 1977 using fewer people with faster production and far greater over-run than the 1973 operation. With the sifter the corporation is now selling wood chips for pulp which it was not doing in 1973. All these items indicate a greater percentage profitability than 1973. You have indicated that 100,000 board feet of lumber per day, per day shift, will be achievable which at 20 days per month for say 10 months per year would be 20 million board feet for a full year, ie 2/3 increase over 1973. It is suggested that you thoroughly check this assumption from a production and marketing viewpoint with third parties prior to acquisition. Using 1973 sales dollars and cost of lumber sold as a base, a new year's operations could look as follows:

**BASED ON ONE SHIFT OPERATIONS**

	1973		12 months ended October 31, 1978	
Net Sales	2,578,153	100.0%	4,296,923	100.0% (166.66% of 1973)
Cost of Lumber Sold	1,702,848			
Less: Excess officers salary - bonus	(45,000)			
	<u>1,657,848</u>	64.3%	<u>2,148,462</u>	(say 50% because of above efficiencies)
Gross Profit	<u>920,305</u>	35.7%	<u>2,148,461</u>	50.0%
Less: Admin. and Shipping Exp.	134,385			
Less: Excess officer salary - bonus	(12,500)			
	<u>121,885</u>	4.7%	<u>171,877</u>	4.0% (say 4% for greater efficiency)
Adjusted Net Profit before tax	<u>798,420</u>	30.0%	<u>1,976,584</u>	46.0%
Provision for income tax - approx.	<u>370,000</u>	14.4%	<u>780,634</u>	18.4%
NET INCOME	<u>\$ 428,420</u>	16.6%	<u>\$1,195,950</u>	27.6%

**EXHIBIT E**

PETER H. TOWNSEND

[Address Omitted]

**LANDRETH TIMBER COMPANY, INC.  
CASH FLOW PROJECTION  
FOR THE TWELVE MONTHS ENDED  
AUGUST 31, 1978  
(UNAUDITED)**

Mr. Samuel S. Dennis III  
Hale and Dorr  
28 State Street  
Boston, Mass. 02109

I have prepared the attached unaudited Cash Flow Projection for the above period based on information given to me by Mr. Ivan Landreth, President of Landreth Timber, Inc. This information may or may not be true. No figures have been included for bank borrowing, bank repayment nor interest. No federal income tax expense has been shown. Because of the impossibility of ensuring that this projection will be met, and as there are so many variables, I cannot express an opinion thereon. It is recommended that you have people who are experts in production and marketing of lumber review the attached forecast and its underlying assumptions before taking any action thereon. This material has been prepared with the understanding that it is only for use by you, First National Bank of Boston and Rainier National Bank and that it will not be released to third parties. This cash flow projection has been prepared after a 2 day visit in Wenatchee, WA and Tonasket, WA with Mr. Landreth and his CPA. It has been prepared under very short notice and as a result critical information may have been omitted or mis-stated.



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## LANDRETH TIMBER COMPANY, INC.

MR. LANDRETH'S CONSERVATIVE DAILY  
ANALYSIS OF SALES MIX AND SELLING PRICES  
 (BASED ON FULL, EFFICIENT PRODUCTION OF MILL)

SALES m FEET		\$ SELLING PRICE	\$ TOTAL SALES
4	CLEARs (rough green R List clear, planed)	400	1,600
52	LANSTOCK	300	15,600
16	2 and better FRAMING LUMBER. Best grade.	250	4,000
6.4	#3 FRAMING LUMBER. Intermediate.	140	896
1.6	#4 FRAMING LUMBER. Economy.	60	96
20	TIMBERS	270	5,400
-	CHIPS	--	300
100.0			27,892
	Less: Contingency 15%		4,184
			23,708
	Per month = 21 x 23,708 (2,100 m feet)		\$497,700
	Average selling price per m feet:		\$ 237

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LOGS NEEDED FOR PRODUCTION:	LOGS IN M FEET	OVER- RUN	M FEET LUMBER OUT	AVERAGE SELLING PER M FEET	SALES	CASH RECEIVED IN CURRENT MONTH 1/4 in current month 3/4 in next month
NOVEMBER 1977						11,000 (per Landreth)
OCTOBER 1977						
Halle Mill:						
Single shift 1st week. 65% production = 5 1/2 days x 65% x 21m	72					
Single shift 2nd week. 80% production = 5 1/2 days x 80% x 21m	88					
Double shift last two weeks full production = 2 x 10 1/2 days x 21m	441 601	1408	841	237	199,317	99,639
NOVEMBER 1977						
Halle Mill:						
Double shift = 2 x 21 days x 21m per day	882	.04	1,233			
Maxi-Mill Single Shift						
1st Month 40% capacity = 40% x 21 x 30m	326 1,210	1804	590 1,923	237	432,525	315,927
DECEMBER 1977						
Halle Mill:						
Same as November 1977	832	1404	1,235			
Maxi-Mill:						
Balance to make 1,260m total (Approximately 45% capacity), (70% possible capacity)	378 1,260	1004	510 1,915			
Only operating 3 weeks = 3 x 5 1/2 21	945		1,436	237	340,342	385,429

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LOGS NEEDED FOR PRODUCTION (CONT.)	LOGS IN M FEET	OVER- RUN	M FEET LUMBER OUT	AVERAGE SELLING PER M FEET	SALES	CASH RECEIVED IN CURRENT MONTH 1/4 in current month 3/4 in next month
JANUARY 1978						
Maxi-Mill:						
85% Production = 85% x 21 x 39m	696	1808	1,253			
Halle Mill:						
Balance Single Shift only 21 days x 21m	441 1,137	1408	617 1,870			
Only Operating 3 weeks 3 x 5 1/2 21	853		1,405	237	332,511	376,422
FEBRUARY 1978						
Same as January 1978 (3 weeks)	853	-	-	-	332,511	332,511
MARCH 1978						
Maxi-Mill:						
100% Production Single Shift 21 days x 39m	819	1808	1,474			
Halle Mill:						
100% Production Single Shift 21 days x 21m	441 1,260	1408	617 2,091	237	495,567	495,567
APRIL - AUGUST 1978						
Same as March 1978	1,260				495,567	495,567

## SCHEDULE OF LOGS REQUIRED FROM FOREST FOR EACH MONTH

(in feet)	A	B	C	C - (A - B)	COST OF LOGS FROM FOREST (ONE MONTH TIME LAG FOR PAYMENT)
	LOGS IN INVENTORY AT BEGINNING MONTH	LOGS IN INVENTORY USED MONTH	LOGS REQUIRED IN INVENTORY (AVERAGE 2 TIMES NEXT MONTH'S PRODUCTION)	LOGS REQUIRED IN MONTH FROM FOREST	
1977					
Sept.	1,200	-	1,200	-	-
Oct.	1,200	601	1,815	1,214	145,680
Nov.	1,815	1,210	1,890	1,285	179,150
Dec.	1,800	945	1,706	*1,450	246,500
1978					
Jan.	1,700	853	2,500 est.	*1,450	246,500
Feb.	2,500	853	3,000 est.	*1,450	246,500
March	3,000	1,260	1,740	** Mill	
April	1,740	1,260	2,520	*1,450	246,500
May	2,520	1,260	2,520	1,260	214,200
June	2,520	1,260	2,520	1,260	214,200
July	2,520	1,260	2,520	1,260	214,200
August	2,520	1,260	2,520	1,260	214,200

\*Smoothed Production  
 \*\*Spring 78 run-off -- forest roads closed

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## LANDRETH TIMBER COMPANY, INC.

## SCHEDULE OF MONTHLY MANAGEMENT SALARIES

	(ANNUAL)	LENGTH OF SERVICE
President/Marketing Director	60,000	-
Plant Superintendent George Worrell	21,000	6 months
General Superintendent and Office Manager L. Don Zabreznik	18,000	13 years
Woods Superintendent R. Lester Shertenlieb	18,000	13 years
Saw-mill Foreman	16,000	12 years
Planer-mill Foreman	16,000	12 years
Woods Foreman	18,000	2 years
Contingency (including Mr. Landreth as consultant)	15,000 <u>182,000</u>	-
MONTHLY SALARIES	<u>182,000</u> 12 = <u>\$15,167</u>	

## SCHEDULE OF APPROXIMATE MONTHLY HOURLY EMPLOYEES WAGES (ONE SHIFT)

	(HOURLY)
General and office	50.25
Saw-mill	103.25
Planer-mill	54.50
Woods - logging and road-building approx. \$50.00 but covered in cost of logs landed at mill (loggers paid by piece work)	-
Contingency 4 people at \$6.00	<u>24.00</u> 232.00
Wage increase per Mr. Landreth - 10%	<u>23.00</u>
	255.20

MONTHLY HOURLY WAGES \$255.20 x 8 hrs. x 21 days = \$42,874



LANDRETH TIMBER COMPANY, INC.  
ASSUMPTIONS

1. Maxi mill to handle 70% of lumber (not logs) with 80% overrun.
2. Helle mill to handle 30% of lumber (not logs) with 40% overrun.
3. Maxi mill starts 11/1/77 and takes until 1/31/78 to be fully efficient.
4. Helle mill starts 10/1/77 and takes 2 weeks to achieve full efficiency. For the initial period, the Helle mill will run two shifts.
5. Expected full and efficient production on both mills starts 2/1/78, assuming log availability and reasonable weather for working at mill.
6. Efficient and optimum operation requires logs large in size and suitable for lamstock. Except for initial 2 or 3 months of Helle mill, only a one-shift operation has been scheduled.
7. A working month consists of 21 working days.

8.

Optimum Level of Mill	m Feet Daily Log Input	Overrun	m Feet Daily Lumber Output
Maxi	39,000	80%	70,000
Helle	21,000	40%	30,000
	<u>60,000 (1,260 m monthly)</u>		<u>100,000 (2,160 m monthly)</u>
	66.6% (Average)		

9. Owing to lack of capacity of present kiln drier, Mr. Landreth estimates that 20% of production will be rough green timbers—these require no drying nor planing.
10. Selling prices are based on Mr. Landreth's figures which he terms conservative; Mr. Landreth indicated

that he expects all the production can be sold at the selling prices indicated.

11. Accounting and taxes include \$3,500 cash forecast and pre-acquisition comfort-letter work, set up of financial statements on computer and unaudited monthly financial statements and management advisory services.
12. Consulting includes cost of foresters, engineers, etc.
13. Repairs and supplies were \$43,717 for 1/1/77—6/30/77, i.e., \$7,000 monthly including repairs for fire damage. The present best guesstimate is \$10,000/month in production as the mill equipment is new.
14. Business taxes include 4% of sales for business and occupation taxes for Washington State plus \$20,000 for real and personal property taxes.
15. Shipping costs are not included. Selling prices are FOB the Tonasket, WA mill. Shipping labor is already included under hourly wages.
16. Travel is based on *monthly* expenses of the president for air-travel (\$1,000), hotels (10 days @ 30 = \$300) and meals (10 days @ 30 = \$300): \$1,600 + \$400 contingency = \$2,000.
17. No capital expenditures are shown beyond the \$500,000 needed to complete the Steel Building, Maxi Mill and Helle Mill. Approximately \$705,000 insurance proceeds were received for the 1977 fire damage and Mr. Landreth expects to spend approximately \$800,000 on replacements.
18. There is a 30 day production cycle—1 week for logging, 1 week for hauling, 1 week for sawing and edging, 1 week for kiln drying/baling, ready for shipment.

19. All equipment, vehicles and buildings will not need replacing in the first year of the new operation. No expenditures have been shown for possible kiln drier and edger additions.
20. Payroll Taxes—These have been estimated at:
- |               |  |
|---------------|--|
| 5.85%         | Social Security  |
| 1.00%         | Federal Unemployment (including<br>WA State percentage)                                    |
| 2.00%         | Employment Security  |
| 20.00%        | Industrial Insurance 88¢ hr.—sawmill,<br>but say \$1.00 due to expected rate<br>increases) |
| <u>28.85%</u> | <u>But say 30%</u>   |
21. Mr. Landreth indicated that there are two unrecorded credits on his books. One is for approximately \$50,000 for forest roads which have been built and for which the U.S. Forest Service will give credit against future purchases of timber. This has not been shown as a credit in the cash flow projection. The other credit, or hidden asset, is for 2,000,000 ft. of logs which have been cut, skidded and decked, but not scaled in the forest; at \$50 per m feet, this is \$100,000 which is not included in the August 31, 1977 financial statements; however, this \$100,000 has been taken into account in the cash flow projection.
22. According to Mr. Landreth, the cash flow is sufficient so that the proceeds from sales of lumber are received in time to make payment to the U.S. Forest Service for the logs which have been used to produce the same lumber which has been sold.
23. Mr. Landreth believes that is would be straight forward to get a performance bond to avoid paying the U.S. Forest Service in advance for logs hauled

- past the scales. His cost estimate is \$1,800 annually and he indicates that he gives a personal guarantee to the bonding company for performance on timber contracts. Therefore, it is assumed that payment on such contracts will continue in a similar manner under new ownership.
24. A contingency amount of \$5,000 monthly has been included.

October 14, 1977

Mr. Samuel S. Dennis III  
Hale and Door (sic)  
28 State Street  
Boston, Mass. 02109

**LANDRETH TIMBER COMPANY, INC.**

Dear Sam,

I am attaching a memo on internal control matters as a result of our September 29 and 30 visit to the Company.

Other items:

1. Tom Wood asked me for average selling prices over the last 4 years—from the CPA's figures. These came out at \$183.40 m ft. for planed lumber and \$320.24 m ft. for rough lumber (including lamstock).
2. I have attached a copy of the 9/30/77 inventory showing 1,045 m. ft. of logs.
3. Personal property has been valued as of 1/1/76 by the county assessor at \$526,157 at 14.679 mils levy rate.
4. 1977 real property has been valued as of 1/1/76 by the county assessor at \$102,576 (10 acres for mill and land improvements). The other 56.7 acres has an assessed value of \$5,103 as of 1/1/76.
5. I have enclosed our billing for the financial review, which is within our estimate.



6. Jack Branch mentioned that he had forwarded our August 9 billing of \$2,005.13 for payment by you less the \$1,000.00 paid by him on account on 9/15/77. This leaves \$1,005.13 for payment. A copy of the billing is attached.
7. I will call you shortly on various pending matters.

Sincerely,

/s/ Peter

PETER H. TOWNSEND, President

October 14, 1977

Memo to: Mr. Sam S. Dennis II

From: Peter Townsend

*Subject: Landreth Timber Company, Inc.—  
Internal Control*

The following are observations following our visit to the Company in Tonasket on September 30 and 31, 1977:

1. It appeared that Mrs. Vivienne Burse, the book-keeper, has a good grasp of the accounting function and that she should be able to provide the necessary timely general ledger data for accurate monthly financial statements, as well as being able to handle the accounting work load.
2. No time cards are used. Hours are kept by each foreman for his own people in a book.
3. No employee hourly rates or rate history are shown on employee wage record cards.
4. Purchase orders are 2-part only—Ivan does not use them. However, the mill manager and officer manager do. It is recommended that three part P.O.'s be used, with the extra copy being a follow-up and matching copy, to eventually be filed with purchase invoices. It is also suggested that a receiving log for invoicing goods be established.
5. Employees get lumber at retail less 10%.
6. Before invoices are paid it is recommended that a stamp be used indicating P.O. checked against invoice, date goods delivered, initials of receiving department or person, prices and extensions checked, date invoice paid, account number to be charged, etc.
7. Cash discounts are being taken on purchases where applicable. No separate account of these discounts is kept.

8. Ivan approves timber purchase statements and indicates which payables are to be paid and when.
9. By showing monthly totals of invoices in, cash paid, opening and closing balances, an agreed accounts payable account could be prepared monthly.
10. At present Ivan signs most of the checks, or in his absence Mr. Ben Zabreznik signs. Only one signature is required on checks. For improved internal control it is recommended that say 2 of any 3 or 4 signatures be required for each check. Ivan is the only signatory on the savings account.
11. It is suggested that a monthly accounts receivable aging list be prepared.
12. It is suggested that a set of corporate objectives, an organization chart and job descriptions and responsibilities be prepared.
13. It is suggested that a second person double check customer invoices.
14. In order to ensure that all sales are invoiced and accounted for, it is suggested that a log of unit tags compared with sales invoice numbers be kept independently of the shipping section and that all unused tags be kept under lock and key.
15. All cancelled invoices should be entered in the sales register as void so that it can be seen that each invoice by number has been accounted for.
16. Invoices could be imprinted with "2% discount for payment within 10 days of invoice date". At present, this information is typed.
17. Ivan opens all mail and deposits all checks. It appears that further subdivision of these and other tasks which he performs will need to be made to other office people with a view to obtaining better internal control.

18. Ivan and Don Zabreznik have the complete safe combination. Vivienne has the partial combination which is the one normally used. There is a fidelity bond for key employees.
19. I have a rough schedule of Company insurance coverage but I believe that it would be advantageous to have a complete insurance schedule showing risks covered, amount covered, carriers, deductibles, period covered, premiums, etc.
20. Don and Vivienne both handle petty cash. It is suggested that one person be given sole responsibility. Petty cash slips should preferably be used for all transactions.
21. As Ivan is so close to the operation he has not had any special sales, costs or expense schedules prepared. A reporting system for this and similar matters should be established.
22. A good system of internal control should be established for sales of sawdust, chips, etc.
23. A formal system of preventive maintenance with record cards for each piece of equipment should possibly be established. To my knowledge there is no plant ledger listing all equipment by number.
24. There are no fireproof cabinets for important books, documents and records.
25. A capital expenditure plan and an operating budget should be established.
26. Employee benefits/vacations may need reviewing.
27. A tighter control of paperwork to account for logs between scaling and being received at the mill could be established.
28. It may be prudent to rent a safe deposit box at the local bank. Many important papers are presently kept at Ivan's home.

- This list may not be comprehensive as only a short visit was made. A more in depth review of this could be made at a later date.

187 Select	575
187 Lumber	575
187 Utility	1075
187 Whitewood	
186 Select	1075
186 Utility	1075
186 Whitewood	1075
185 Select	575
185 Lumber	575
185 St. & Lumber	1075
185 Utility	200
282 Select	1375
283 Select	1525
283 St. & Lumber	1075
283 Economy	1375
284 Select	1075
284 Lumber	700
284 Economy	1375
284 Whitewood	1075
286 Select	1375
286 #12	785
286 #4	1375
286 Whitewood	1250
288 Select	1375
288 #4	1375
288 Whitewood	110
288 Select	700
288 #4	250
288 #4	700
Rough Lumber	2400
	22875
Fast & Lumber	45000
Spine Lumber	14000
Frame Lumber	21000
	100000



PETER H. TOWNSEND

[Address Omitted]

Mr. Samuel S. Dennis II  
Hale and Door (sic)  
28 State Street  
Boston, Mass. 02109

October 18, 1977  
#931

## For Professional Services

9/30-10/17 Visit Landreth Timber Company, Inc. in  
Tonasket, WA by Mr. Townsend and Miss Richards.  
Make limited financial review as per our September  
21, 1977 letter. Prepare report on limited financial  
review performed. Prepare memo on internal control  
findings. Review cash flow projection assumptions.

Discuss results of findings with you in Federal Way.	2,150.00
Nights hotel bills	116.67
Meals	50.19
Mileage—560 miles at 15¢	84.00
Phone calls	11.98
	<u>\$2,412.84</u>

PETER H. TOWNSEND

[Address Omitted]

August 9, 1977

Mr. Jack Branch, President  
Timber West, Inc.  
300 120th NE  
Bldg. 3, Suite 200  
Bellevue, WA 98005

Re: Landreth Timber Co.

Aug. 1977

Visit your offices in Bellevue and discuss  
proposed acquisition of Landreth Timber  
Co. with you and Mr. Ivan Landreth. Vari-  
ous phone conversations with you. Travel  
to Wenatchee, WA to visit Mr. Pat Peyton,  
CPA to gather additional financial and tax  
information on the company. Visit To-  
nasket, WA to review operating and finan-  
cial matters with Mr. Landreth. Prepare de-  
tailed report for you covering my findings.

1,800.00

Disbursements: Auto—560 miles at 15 cents	84.00	
Hotel—Wenatchee	34.45	
Hotel—Omak	27.85	
Meals—Evening Fri.—Wenatchee	22.00	
Breakfast and lunch Sat.—Tonasket	13.00	
Dinner Sat.—Omak	9.83	
Breakfast Sun.—Twisp	8.00	
Lunch Sun.—Concrete	6.00	205.13
		<u>2,005.13</u>
		<u>1,000.00</u>
		<u>\$1,005.13</u>

## ONE Old National Bank

October 3, 1977

Peter Townsend & Associates  
 Certified Public Accountants  
 31003 18th Avenue South  
 Federal Way, Wa 98003

Gentlemen:

Mr. Ivan Landreth of Landreth Timber Company, Inc., has asked us to furnish the following information in connection with the financial review your firm is making of his Corporation. The following is taken from our records.

The Corporate checking account balance was \$577.36 on August 31, 1977, and \$577.36 on September 30, 1977.

The loan against the sawmill, which is 90% guaranteed by the Small Business Administration was as follows:

On August 31, 1977, the balance was \$253,094.74. Payment schedule called for \$2,200.00 per month on the twenty fifth of each month. Interest rate was 9 $\frac{1}{4}$ % APR. Accrued interest from August 24, 1977 was \$448.98.

On September 20, 1977, this loan was revised and re-termed. As of September 30, 1977, the balance was \$249,934.90, payable \$5400.00 per month at 9 $\frac{1}{2}$ % APR. Payments are due on the twenty fifth of each month with the balance in full by August 25, 1982. Accrued interest to September 30, 1977 was \$130.13.

Should you need further information, please let us know.

Sincerely,

/s/ H. W. Burse  
 H. W. BURSE  
 Manager

HWB/aj  
 cc: Ivan Landreth

PETER H. TOWNSEND

[Address Omitted]

October 14, 1977

Mr. Ivan K. Landreth—President  
 Landreth Timber Co., Inc.  
 Box 505  
 Tonasket, WA 98855

Dear Ivan,

To complete our analysis of depreciation and investment credit would you please let us have a detailed listing of fixed assets of Landreth Timber Co. We talked with Mr. Pat Peyton regarding the easiest way to obtain this information. He suggested taking copies of the yearly fixed asset cards for the assets and years as follows:

<u>General Ledger Description</u>	<u>Year of Purchase</u>	<u>Amount</u>
Logging & Yard Equipment		
Road Equipment	1967	28,129
Road Equipment	1970	25,708
Road Equipment	1971	4,511
Log Yard Equipment	1967	32,591
Log Yard Equipment	1970	2,500
Logging Equipment	1973	19,000
Yard		
Yard Equipment	1968	7,461
Yard Equipment	1969	13,743
Yard Equipment	1970	3,876
Yard Equipment	1972	433
Yard Equipment	1973	9,335

If the general ledger cards do not show the detailed costs and assets, would you please ask Vivienne if she could make the necessary analysis. We need details of the actual machines and equipment, not merely references in the general ledger to the check register or sales journal.

One other item, we have not yet received the bank confirmation from Mid Valley Bank. Can you please expedite this. We did get the confirmation from Old National Bank.

Sincerely,

/s/ PHT  
PETER H. TOWNSEND

# EXHIBIT G

PETER H. TOWNSEND

[Address Omitted]

LANDRETH TIMBER COMPANY, INC.  
CASH FLOW PROJECTION  
FOR THE TWELVE MONTHS ENDED  
OCTOBER 31, 1978  
(UNAUDITED)

November 4, 1977

Mr. Samuel S. Dennis III  
Hale and Dorr  
28 State Street  
Boston, Mass. 02109

I have prepared the attached unaudited Cash Flow Projection for the above period based on information given to me by Mr. Ivan Landreth, President of Landreth Timber Company, Inc. This information may or may not be true. Because of the impossibility of ensuring that this projection will be met, and as there are so many variables, I cannot express an opinion thereon. It is recommended that you have people who are experts in production and marketing of lumber review the attached forecast and its underlying assumptions before taking any action thereon. This material has been prepared with the understanding that it is only for use by you, First National Bank of Boston and Rainier National Bank and that it will not be released to third parties. It has been prepared under very short notice and as a result critical information may have been omitted or mis-stated.

Peter Townsend and Associates



## CONTENTS OF PROJECTION

## SINGLE SHIFT

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## COMBINED SINGLE AND DOUBLE SHIFT

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LAUREN TAYLOR COMPANY, INC. - SEE ACCOUNTANTS REPORT, ASSUMPTIONS, AND NOTES HEREON FOR AN INTEGRAL PART OF THIS PROJECTION. SAME DATES AS CASH FLOW DATED 4/14/77.

11/24/77

CASH FLOW PROJECTION - UNAUDITED

FROM NOVEMBER 1, 1977 TO OCTOBER 31, 1978

	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6	MONTH 7	MONTH 8	MONTH 9	MONTH 10	MONTH 11	MONTH 12	TOTAL
<b>CASH INFLOWS</b>													
SALES	11,000	91,559	315,400	350,429	350,422	332,511	410,233	495,557	495,557	495,557	495,557	495,557	4,513,818
LOAN - BARNER BANK - 9-1/2%	150,000	0	1,000,000	0	0	0	0	0	0	0	0	0	1,150,000
LOAN - OTHER SOURCE - 8-1/2%	500,000	0	0	0	0	0	0	0	0	0	0	0	500,000
LOAN - DEBENTURES/BOLTON	0	200,000	310,000	0	0	0	0	0	0	0	0	0	510,000
STOCK - DEBENTURES/BOLTON	200,000	0	0	0	0	0	0	0	0	0	0	0	200,000
<b>TOTAL INFLOWS</b>	<b>911,000</b>	<b>291,559</b>	<b>3,075,400</b>	<b>350,429</b>	<b>350,422</b>	<b>332,511</b>	<b>410,233</b>	<b>495,557</b>	<b>495,557</b>	<b>495,557</b>	<b>495,557</b>	<b>495,557</b>	<b>9,233,315</b>
<b>CASH OUTFLOWS</b>													
SALARIES MANAGEMENT	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	182,354
SALES - GENERAL & OFFICE	32,374	42,374	42,374	42,374	42,374	42,374	42,374	42,374	42,374	42,374	42,374	42,374	504,438
WILL LARSEN LSC COST	3,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	11,000
TOTAL STAMPEE DEPOSITS	0	0	0	0	0	0	0	0	0	0	0	0	0
DISCOUNTS ALLOWED - 2%	200	1,393	6,313	7,254	6,728	6,357	8,281	12,552	12,552	12,552	12,552	12,552	151,144
PAYROLL TAXES	9,557	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	144,000
INSURANCE - ALL KINDS	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
REPAIRS AND SUPPLIES	500	500	500	500	500	500	500	500	500	500	500	500	6,000
BUSINESS TAXES	500	500	500	500	500	500	500	500	500	500	500	500	6,000
EQUIPMENT RENTAL/LEASE	4,000	6,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	84,000
LEGAL	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000
OFFICE SUPPLIES AND EXPENSES	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
TRAVEL	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000
AUTO AND TRUCK	500	500	500	500	500	500	500	500	500	500	500	500	6,000
UTILITIES AND TELEPHONE	500	500	500	500	500	500	500	500	500	500	500	500	6,000
ACCOUNTING TAX	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
BUSINESS PROVISION	150	150	150	150	150	150	150	150	150	150	150	150	1,800
ADVERTISING	400	400	400	400	400	400	400	400	400	400	400	400	4,800
CONSULTING	500	500	500	500	500	500	500	500	500	500	500	500	6,000
CAPITAL EXPENDITURES	90,000	13,000	0	0	0	0	0	0	0	0	0	0	103,000
CONTINGENCY	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	60,000
PAYMENT TO MR. LAUREN - SALE	0	0	0	0	0	0	0	0	0	0	0	0	0
REPAY LAUREN NOTE & INTEREST	20,000	0	0	0	0	0	0	0	0	0	0	0	20,000
REPAY LOANS TO LOCAL BANKS	405,000	0	0	0	0	0	0	0	0	0	0	0	405,000
INTEREST PAID - 10% PRINCIPAL	0	0	0	0	0	0	0	0	0	0	0	0	0
INCOME TAX - 30% RECEIPT	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>TOTAL OUTFLOWS</b>	<b>572,161</b>	<b>161,777</b>	<b>3,231,339</b>	<b>5,221</b>	<b>5,221</b>	<b>5,221</b>	<b>5,221</b>	<b>5,221</b>	<b>5,221</b>	<b>5,221</b>	<b>5,221</b>	<b>5,221</b>	<b>7,403,359</b>
<b>CASH BEGINNING OF MONTH</b>	<b>7,000</b>	<b>231,559</b>	<b>315,400</b>	<b>103,951</b>	<b>225,169</b>	<b>149,146</b>	<b>25,637</b>	<b>33,330</b>	<b>34,711</b>	<b>627,483</b>	<b>539,145</b>	<b>700,337</b>	
<b>CASH END OF MONTH</b>	<b>231,559</b>	<b>315,400</b>	<b>103,951</b>	<b>225,169</b>	<b>149,146</b>	<b>25,637</b>	<b>33,330</b>	<b>34,711</b>	<b>627,483</b>	<b>539,145</b>	<b>700,337</b>	<b>777,555</b>	

*Landreth Timber Company, Inc. (L.T.C.)**Revised Cash Flow Projection**November 1, 1977 thru October 31, 1978 (Single Shift)**New assumptions from original cash flow projection dated 9/15/77*

1. It has been assumed that the new L.T.C. will acquire the stock of the old L.T.C. on approximately November 15, 1977 and will then immediately liquidate the old L.T.C. and merge its assets with the new L.T.C.
2. Production will only start on December 1, 1977 under the new L.T.C.
3. For income tax purposes it has been assumed that:
  - a) \$1,523,000 is the fair market value of new saw-mill equipment (excluding building) and that this will qualify for 10% investment tax credit of \$152,300 in the new L.T.C. It has been assumed that as this equipment has not been placed into service with the old L.T.C., it will be first placed into service in the new L.T.C. and therefore qualify for the above \$152,300 investment tax credit.
  - b) There will be approximate tax loss for 1/1/77—11/30/77 of approximately \$302,000—this loss has been arrived at by continuing the trend of the 5/30/77 and 8/31/77 unaudited financial statements.
  - c) On liquidation of old L.T.C. there will be approximately \$46,614 of income tax to be paid consisting of (i) tax on \$352,000 depreciation recapture less \$302,000 operating loss in 3(b) above, (ii) \$21,000 investment tax credit recapture, and (iii) \$15,000 tax as contingency.

Because of the tax complexity and questions of law, the necessary tax schedules and assumptions have been forwarded to Mr. Dennis' law firm for confirmation by their tax department.

4. After the initial capital expenditures of approximately \$865,000 have been made through December 1977, an extra \$80,000 has been "guesstimated" to be spent later in the fiscal year ended 10/31/78.
5. This revised cash flow assumes that there has been a two month start-up slippage from the original cash flow prepared on 9/15/77 due to a) Mr. Landreth's later than forecast construction completion, and b) the need to not put new equipment into service until it is owned by new L.T.C. Apart from the fact that a) receipts for share capital and loans, and b) payments for stock purchase price, bank interest and local repayments have been shown in this projection, all other assumptions of the 9/15/77 cash flow projection apply and should be read together with these additional notes and assumptions.
6. For cash flow purchases old L.T.C. and new L.T.C. have been treated as one.
7. According to Mr. Landreth \$61,000 of capital expenditures were made in October 1977. As at 9/30/77 Mr. Landreth estimated that there was \$164,000 of remaining capital expenditures to be made. This leaves a balance of \$103,000 plus a contingency of \$30,000 to be spent in November and December 1977.
8. No dividends have been included in the cash flow projection.
9. For simplicity, interest on loans (including an estimated \$510,000 from Mr. Dennis and Mr. Bolton have been shown as having an average rate of 9¼% interest paid quarterly, with no principle payments starting until 1/1/79.
10. No interest received has been shown on cash balances which are excess to operational needs.

11. According to our attached tax computation there will be no income tax payable on the profits for the year ended October 31, 1977 except for the recapture of \$46,614 in paragraph 3 c) above.

LANDRETH TIMBER COMPANY, INC.Income Tax Calculations:

Assume liquidate old company on 12/1/77 (No operations in Nov.)	1/1/77 thru 6/30/77	12/1/77 thru 8/31/77	Diff. - 2 months July/Aug. 77
Loss in 1977	73,622	159,153	85,531
Loss per month - average $\frac{85,531}{2} = 42,766$			
<hr/>			
Actual loss 1/1/77 - 8/31/77	(159,153)		
3 months extra loss thru 11/30/77 3 x 42,766	(128,298)		
Estimated loss 1/1/77 - 11/30/77	\$(287,451)	Assuming no Nov. 77 operations	
Extra adjustments re income in Nov.	( 15,000)		
Expected 1977 tax loss thru 11/30/77	(302,451)		
Expected depreciation recapture per schedule	352,011		
To be recaptured	49,560	1977 Taxable Income	
Average 21% tax	10,408		
Investment tax credit recapture	21,206		
Contingency tax	15,000		
Total Income Tax Payable February 1978	\$ 46,614		



## 146

Fair Market value 12/31/77 per appraisal	Method	Life (years)		Single Shift	Double Shift
		Single Shift	Double Shift		
<b>Buildings</b>					
New construction	150% SL	20	20	11,025	11,025
Existing buildings		9	9	5,111	5,111
<b>Equipment</b>					
New construction (ignored bonus depreciation)	200%	7	6	445,057	519,233
Existing equipment	150%	4 yrs.	3	212,650	283,400
Mobile and highway Equipment - Existing	150%	4 yrs.	3	89,250	119,000
				762,033	937,769
Timber cutting contracts		as consumed	(13/30)	321,100	(20/30) 494,000
Inventory					
Land and improvements					
				\$1,081,093	\$1,431,769

Draft Projected Income Statement  
(Unaudited)

12 Months Dated 10/31/70

		\$
Sales		4,373,815
Salaries	182,004	
Wages	504,488	
Cost of logs	1,959,430	
Less: Build up of inventory (extra 1,200m logs and some lumber)	(254,000)	
Stampage deposits	16,000	
Cash discounts	87,474	
Payroll taxes	151,344	
Insurance	45,000	
Repairs	120,000	
Business taxes	41,870	
Equipment rental	100,000	
Legal	19,000	
Office supplies	12,000	
Travel	24,000	
Auto and truck	6,000	
Utilities and Phone	72,000	
Accounting, tax and financial advice	14,300	
Dues and subscriptions	4,000	
Business promotion	1,800	
Advertising	7,200	
Consulting	6,900	
Contingency	60,000	
Interest - Landreth note (\$20,000)	3,000	
Interest - Legal banks	5,000	
Interest on acquisition indebtedness	310,235	
	3,499,045	
Depreciation	762,993	
Depletion of timber contract	321,100	
		4,563,138
Net loss for year - therefore no income tax payable		\$ (200,321)

(Figures are taken from 11/3/77 cash flow projection and from draft income tax computations.)

CASH FLOW PROJECTION - UNAUDITED

FROM NOVEMBER 1, 1977 TO OCTOBER 31, 1978

	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6	MONTH 7	MONTH 8	MONTH 9	MONTH 10	MONTH 11	MONTH 12	TOTAL
<b>CASH INFLOWS</b>													
SALES	0	0	0	0	0	18,338	277,903	421,358	421,358	421,358	421,358	421,358	2,565,475
LOAN - MATHEW BANK - 9-1/2%	0	0	0	0	0	0	0	0	0	0	0	0	0
LOAN - OTHER SOURCE - 8-1/2%	0	0	0	0	0	0	0	0	0	0	0	0	0
LOAN - DEPOSIT/ROLLIN	0	0	0	0	0	0	0	0	0	0	0	0	0
STOCK - DEPOSIT/ROLLIN	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>TOTAL INFLOWS</b>	0	0	0	0	0	18,338	277,903	421,358	421,358	421,358	421,358	421,358	2,565,475
<b>CASH OUTFLOWS</b>													
SALARIES MANAGEMENT	0	0	0	0	0	2,200	2,200	2,200	2,200	2,200	2,200	2,200	16,380
WAGES - GENERAL S. OFFICE	0	0	0	0	0	13,916	47,141	47,141	47,141	47,141	47,141	47,141	285,739
WELL-MAINTAINED LOG COST	0	0	0	0	0	12,346	55,491	122,807	187,684	187,684	187,684	187,684	864,840
THINER STUMPAGE DEPOSITS	0	0	0	0	0	0	0	0	0	0	0	0	0
DISCOUNTS ALLOWED - 2%	0	0	0	0	0	0	0	0	0	0	0	0	0
PAYROLL TAXES	0	0	0	0	0	1,689	5,458	5,458	5,458	5,458	5,458	5,458	38,311
INSURANCE - ALL KINDS	0	0	0	0	0	2,088	10,200	10,200	10,200	10,200	10,200	10,200	80,200
REPAIRS AND SUPPLIES	0	0	0	0	0	1,400	1,400	1,400	1,400	1,400	1,400	1,400	12,200
BUSINESS TAXES	0	0	0	0	0	1,400	1,400	1,400	1,400	1,400	1,400	1,400	12,200
EQUIPMENT RENTAL/LEASE	0	0	0	0	0	0	0	0	0	0	0	0	0
LEGAL	0	0	0	0	0	0	0	0	0	0	0	0	0
OFFICE SUPPLIES AND EXPENSES	0	0	0	0	0	0	0	0	0	0	0	0	0
AUTO AND TRUCK	0	0	0	0	0	0	0	0	0	0	0	0	0
UTILITIES AND TELEPHONE	0	0	0	0	0	0	0	0	0	0	0	0	0
ADVERTISING, TRAVEL	0	0	0	0	0	0	0	0	0	0	0	0	0
DEURS AND SUBSCRIPTION	0	0	0	0	0	0	0	0	0	0	0	0	0
BUSINESS PROTECTION	0	0	0	0	0	0	0	0	0	0	0	0	0
ADVERTISING	0	0	0	0	0	0	0	0	0	0	0	0	0
CONSULTING	0	0	0	0	0	0	0	0	0	0	0	0	0
CAPITAL EXPENDITURES	0	0	0	0	0	0	0	0	0	0	0	0	0
CONTRIBUTION	0	0	0	0	0	0	0	0	0	0	0	0	0
PAYMENT TO MR. LAURENCE - SALE	0	0	0	0	0	0	0	0	0	0	0	0	0
REPAY LAURENCE NOTE & INTEREST	0	0	0	0	0	0	0	0	0	0	0	0	0
REPAY LOANS TO LOCAL BANKS	0	0	0	0	0	0	0	0	0	0	0	0	0
INTEREST AND PRINCIPAL	0	0	0	0	0	0	0	0	0	0	0	0	0
INCOME TAX - ONLY RECEIPT	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>TOTAL OUTFLOWS</b>	0	0	0	0	0	42,351	162,410	228,346	337,715	279,715	255,715	337,715	1,759,169
<b>CASH REQUIREMENT OF MONTH</b>	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>CASH END OF MONTH</b>	0	0	0	0	0	0	0	0	0	0	0	0	0

Landreth Timber Company, Inc.

Schedule of extra monthly receipts as result of double shift

Logs Overrun Lumber S.P. Sales Mar. 78 April 78 May 78 June 78 and further

1) Mar. 78 Assume Helle Mill reverts to double shift full time Extra

Less: 13% efficiency decrease

375m @ 140% = 525m @ 237 = \$124,425 61,213 124,425 125,425 124,425

2) May 78 Assume Moxi-Mill double shifts full time

Less: 15% efficiency decrease

696m @ 180% = 1,253m @ 237 = \$296,961 148,480 296,961

Total Extra Collections

61,213 124,425 274,905 421,386

LANDRETH TIMBER COMPANY, INC.EXTRA WAGES PAYMENTS MONTHLY, RE SECOND SHIFT(i) Re Helle Mill Extra Shift

Hourly employees wages  $\frac{617m}{2,091m}$  extra board feet lumber  
 total board feet lumber regular one shift  $\times \$42,874 = \$12,651$

\$42,874 is taken from Schedule of Approximate Monthly Hourly Employees Wages (one shift)  
 attached to 9/14/77 Cash Flow Forecast

+ 10% Night Shift Premium

(ii) Re Maxi-Mill Extra Shifts

Hourly employees wages  $\frac{1,474m}{2,091m}$  extra board feet lumber  
 total board feet lumber regular one shift  $\times \$42,874 = 30,223$   
 (as above)

+ 10% Night Shift Premium

Total extra monthly wages with double shift on both mills

150  
 13,916

1,265

33,245

\$47,161

151

Landreth Timber Company, Inc.Second Shift Income Tax Calculation Y/E 10/31/78

Extra cash flow re second shift per projection	856,324
Add: Capital expenditure	<u>100,000</u>
	956,324
Less: Tax loss on first shift	(209,323)
Extra depreciation on 2nd shift	(174,776)
Extra depletion on 2nd shift	<u>(172,900)</u>
	399,325
Tax @ 42% (including capital gain on timber)	167,717
Less: Investment tax credit -	<u>Qualified Expenditure</u>
New equipment	1,522,800
Used equipment (\$566,800)	<u>100,000</u> (limit)
Less: Investment tax credit	1,622,800 @ 10%
	<u>162,280</u>
Tax to pay on 1/15/79	<u>\$ 5,437</u>



11/31/77

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CASH FLOW PROJECTION - UNAUDITED

FROM NOVEMBER 1, 1977 TO OCTOBER 31, 1979

	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6	MONTH 7	MONTH 8	MONTH 9	MONTH 10	MONTH 11	MONTH 12	TOTAL
<b>CASH INFLOWS</b>													
SALES	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	11,000	132,000
RENT - MINER BUREAU	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	1,800,000
LOAN - OTHER SOURCE	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	1,200,000
LOAN - DEPOSIT/RECEIVE	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	2,400,000
STOCK - DEPOSIT/RECEIVE	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	2,400,000
<b>TOTAL INFLOWS</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>661,000</b>	<b>7,920,000</b>
<b>CASH OUTFLOWS</b>													
SALARIES MANAGEMENT	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	15,167	182,004
SALES - GENERAL & OFFICE	12,374	12,374	12,374	12,374	12,374	12,374	12,374	12,374	12,374	12,374	12,374	12,374	148,488
WILL LAMBERT LTD COST	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	36,000
TIMBER STAMPS/DEPOSITS	9,882	9,882	9,882	9,882	9,882	9,882	9,882	9,882	9,882	9,882	9,882	9,882	118,584
DISCOUNTS ALLOWED - 2%	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
PROPERTY TAXES	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
INSURANCE - ALL KINDS	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
REPAIRS AND SUPPLIES	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
STOCKS/SALES	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
SHIPMENT MATERIAL/REUSE	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
LEGAL	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
OFFICE SUPPLIES AND EXPENSES	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
TRAVEL	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
AUTO AND TRUCK	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
UTILITIES AND TELEPHONE	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
ACCOUNTING, TAX	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
DUES AND SUBSCRIPTIONS	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
BUSINESS PROTECTION	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
ADVERTISING	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
CONSULTING	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
CAPITAL EXPENDITURES	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
CONTINGENCY	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
PAID TO MR. LANDRETH - SALE	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
REPAY LANDRETH NOTE & INTEREST	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
REPAY LOANS TO LOCAL BANKS	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
INTEREST PAID - 10% ANNUAL	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
CHIEF TAX - ONLY RECAPTURE	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	120,000
<b>TOTAL OUTFLOWS</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>672,168</b>	<b>8,065,688</b>
<b>CASH REQUIREMENT, 3RD MONTH</b>													
<b>CASH END OF MONTH</b>													

Landreth Timber Company, Inc.

Assumptions on combined single and double shift cash flow projection for the year ended 10/31/78

Refer to assumptions for a) single shift, and b) double shift on pages 2 and 8 respectively.

## EXHIBIT H

PETER H. TOWNSEND

[Address Omitted]

LANDRETH TIMBER COMPANY, INC.  
 A DELAWARE CORPORATION  
 PROJECTED BALANCE SHEET  
 AS OF NOVEMBER 17, 1977  
 (UNAUDITED)

November 16, 1977

Mr. Samuel S. Dennis III  
 Hale and Dorr  
 28 State Street  
 Boston, Mass. 02190 (sic)

I have prepared the attached unaudited projected Balance Sheet as of November 17, 1977 based on (a) financing information given to me by you and Mr. Tom Wood of Rainier National Bank, (b) current assets and current liabilities given to me by Mr. Ivan Landreth, (c) appraisal information provided in Mr. Pease's October 21, 1977 report on the Company, and (d) other general information from earlier unaudited cash forecasts and reports made to you by me. I cannot express an opinion on this Balance Sheet because it is a projection and may therefore not be achieved and because the information has not been audited by me. This material has been prepared with the understanding that it is only for use by you, First National Bank of Boston and Rainier National Bank and that it will not be released to third parties.

Peter Townsend and Associates

LANDRETH TIMBER COMPANY, INC.  
 PROJECTED BALANCE SHEET NOVEMBER 17, 1977  
 (UNAUDITED) (AFTER CLOSING OF STOCK TRANSFER)

ASSETSCurrent Assets

Cash in bank (\$4,000 in Tonasket, \$20,000 new account)	24,000
Accounts receivable, trade	10,000
Inventories, per valuation	
Lumber	31,000
Logs	193,000
Fuel Oil	2,000
Prepaid insurance	2,000
Timber cutting contracts - current portion - per appraisal	400,000
	<u>662,000</u>

Other Assets

Timber cutting contracts - long term portion - per appraisal	341,000
Organization expenses	31,000
	<u>372,000</u>

Property, Mill and Equipment - per appraisal

Buildings - new construction	147,000	
- existing buildings	46,000	193,000
Sawmill Equipment - new construction	1,557,700	
- existing equipment	566,300	2,124,500
Mobile and Highway equipment		238,000
Land and improvements		126,800
		<u>2,682,300</u>

Additional buildings and equipment over and above Pease appraisal  
 (note3)

82,603TOTAL ASSETS\$3,798,903

See attached notes and assumptions which are an integral part of this projected balance sheet.

LANDRETH TIMBER COMPANY, INC.  
PROJECTED BALANCE SHEET      NOVEMBER 17, 1977  
(UNAUDITED)      (AFTER CLOSING OF STOCK TRANSFER)

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities

Accounts payable, general	3,500
Accounts payable, equipment and buildings*	136,789
Organization expenses payable	25,000
Accrued expenses - wages (non capital item)	4,000
Accrued expenses - tax and withholding	7,000
Federal Income Tax payable on liquidation - payable approx. 2/1/78	46,614
Total Current Liabilities	<u>222,903</u>

Long-Term Loans

5-year bank term loan (not guaranteed, secured by all of assets of business), 2% over prime interest rate, one year moratorium on principal repayment)	1,900,000
Bank term loan (term to be decided, 1% over prime interest rate, secured by S.S. Dennis and J. Bolten joint and several limited guarantee, to be repaid pro-rata with above 5-year bank term loan)	1,000,000
Bank loan (secured by cash equivalent - S.S. Dennis and J. Bolten, 1/2% over prime, repayable after above two loans)	500,000
	<u>3,400,000</u>

Stockholders' Equity

Class A Common Stock, \$2.00 par value, 100,000 shares authorized, 35,000 shares issued	170,000
Class B non-voting stock, \$0.40 par value, 25,000 shares authorized, 15,000 shares issued	6,000
	<u>176,000</u>

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY      \$3,708,993

\*(including 814,000 capitalized wages payable 11/16/77)

See attached notes and assumptions which are an integral part of this projected balance sheet.

LANDRETH TIMBER COMPANY, INC.  
 NOTES AND ASSUMPTIONS FOR PROJECTED  
 NOVEMBER 17, 1977 BALANCE SHEET  
 (UNAUDITED)

1. This balance sheet has been prepared on the assumption that the acquisition of the Landreth family's stock has been completed by B and D Company, and that there has been an immediate IRS Code Section 334 (b) (2) liquidation and then a change of name to Landreth Timber Company, Inc., a Delaware Corporation.
2. The assumptions used in my November 5, 1977 letter and unaudited cash flow projection to you, and in my September 15, 1977 unaudited cash flow projection to you apply to this balance sheet—note should be taken of the expected \$86,582 addition capital expenditure to be spent in November and December 1977 over and above the \$133,000 projected on 11/5/77. This was caused by \$30,950 extra costs over and above Mr. Landreth's 9/30/77 capital expenditure estimate and a misunderstanding regarding \$60,642 paid in October 1977 for capital expenditures.
3. Where there is a reference to "per appraisal" in the Balance Sheet, it refers to the appraisal figures submitted by Mr. Pease in his October 21, 1977 report.
4. Timber cutting contracts have been split into the current portion (which is expected to be amortized within the next 12 months based on earlier log usage assumptions), and into long term portion which is expected to be amortized after the first 12 months operations of the new Corporation.
5. No accumulated depreciation nor amortization has been shown against timber cutting contracts and property, mill and equipment as the new Corporation will



not have commenced operations until November 18, 1977.

6. As instructed by you, additional buildings and equipment cover items which have been omitted or undervalued on Mr. Pease's appraisal.
7. Mr. Landreth has provided the \$136,789 estimate of accounts payable, equipment and buildings.
8. Long-term loans and Stockholders' Equity. This information has been taken from your November 10, 1977 memo and from Mr. Neil Khosla (sic) of your law firm. Loan repayment schedules have not been finalized.
9. It is understood that there will be certain working capital ratio requirements, restrictions on dividends and other possible financial restrictions, which are not known at this point, to be imposed by the lending institutions.

## EXHIBIT I

### CONSULTING AND NONCOMPETITION AGREEMENT

Effective as of November 17, 1977, B&D Company, Inc. (the "Company"), a Delaware corporation, and Ivan K. Landreth (the "Consultant") agree as follows:

#### 1. *Consulting Arrangement.*

1.1. *Consulting Period.* The Company shall employ the Consultant as a consultant to the Company for a period of one (1) year commencing on the date of this Agreement (such period, as it may be extended, the "Consulting Period").

1.2. *Consulting Duties, etc.* The Company shall employ the Consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the Consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as a consultant to the Company in connection with such participation and for such purposes.

#### 2. *Compensation.*

2.1. *Compensation During Consulting Period.* The Company shall pay the Consultant monthly at the rate of Two Thousand Five Hundred Dollars (\$2,500) per month for the first six (6) months of the Consulting Period and at the rate of One Thousand Dollars (\$1,000) per month for the second six (6) months of the Consulting Period.

2.2. *Reimbursement of Costs and Expenses.* Consultant will be reimbursed for his reasonable costs and expenses in connection with the performance of services

specifically requested by the Company upon reasonable substantiation and approval by the Company of such costs and expenses.

3. *Noncompetition.* At all times during the Consulting Period and for a period of three (3) years after termination of the Consulting Period, the Consultant shall not, directly or indirectly, as an employee of any person or entity (whether or not engaged in business for profit), individual proprietor, partner, stockholder, director, officer, joint venturer, investor, lender or in any other capacity whatever, compete with the business of the Company or any subsidiary of the Company (each such subsidiary, a "Company Subsidiary"). As used in this Agreement, "compete", "competition" or any variation thereof, means engagement or participation of the Consultant in, or his furnishing aid or assistance in connection with, the design, manufacture, distribution, sale, marketing or rendering of products or services of the type and kind designed, manufactured, distributed, sold, marketed or rendered by the Company or any Company Subsidiary in the Consulting Period or in the one-year preceding the Consulting Period, including, but not limited to, those products or services the Company or any Company Subsidiary, as the case may be, was then in the process of developing or designing for manufacture, sale, marketing or rendering in the States of California, Idaho, Oregon, Washington and Wyoming.

4. *No Solicitation of Employees.* At all times during the Consulting Period and for a period of three (3) years after termination of the Consulting Period, the Consultant shall not, directly or indirectly, or by any act in concert with others, employ, attempt to employ, recruit or otherwise solicit or induce or influence to leave his employment any employee of the Company or any Company Subsidiary for any purpose. The restrictions described in this Section 4 are applicable in the States of California, Idaho, Oregon, Washington and Wyoming.

5. *No Disclosure of Information.* The Consultant shall not at any time divulge, use, furnish, disclose or make accessible to anyone other than the Company or a Company Subsidiary or their respective directors or officers any knowledge or information with respect to (a) confidential or secret processes, plans, formulas, data (including cost data), machinery, drawings, specifications, manufacturing procedures and techniques, methods, technology, know-how, programs, devices or material relating to the business, products (whether existing or under development), services or activities of the Company or any Company Subsidiary; (b) any confidential or secret engineering, research, development or other original work of the Company or any Company Subsidiary; (c) any other confidential or secret aspects of the business, products or activities of the Company or any Company Subsidiary; or (d) any customer usages and requirements or any customer lists of the Company or any Company Subsidiary. All records, materials and information obtained by the Consultant in the course of his employment by the Company shall be deemed confidential and shall remain the exclusive property of the Company. This provision shall not apply to any information which at any time comes into the public domain other than as a result of the violation of the terms of this Section 5 by the Consultant.

6. *Enforceability.* The Company and the Consultant recognize that any breach by the Consultant of any of his obligations under Sections 3 and 4 would result in irreparable injury and damage to the overall reputation of the Company and to its business and affairs. The Company and the Consultant therefore consider the restrictions contained in Sections 3 and 4 to be reasonable as to the covenants of, and the duties and restrictions imposed on, the Consultant therein, whether in terms of extent, time or geographic area. However, if any such covenants, duties or restrictions are found by any court having competent jurisdiction to be unreasonable because



they are (or any one of them is) too broad, then those covenants, duties or restrictions shall nevertheless remain effective, but shall be considered amended as to extent, time or geographic area (or any one of them, as the case may be) in whatever manner is considered reasonable by such court, and as so amended shall be enforced.

7. *Relief in Case of Breach.* The services to be rendered by the Consultant to the Company in the Consulting Period are unique and extraordinary, which gives them a value peculiar to the Company; and the Company cannot be reasonably or adequately compensated in damages for their loss. Accordingly, any breach by the Consultant of the terms of this Agreement, including, but not limited to, the terms of Sections 3 and 4, will cause the Company irreparable injury and damage. Therefore, the Company shall be entitled, in addition to all other remedies available to it, to injunctive and other available equitable relief in any court of competent jurisdiction to prevent or otherwise restrain a breach of this Agreement, without notice to the Consultant, for the purpose of enforcing this Agreement or any of its terms.

8. *Termination of Employment.* All employment of the Consultant by the Company under this Agreement shall terminate on the earliest to occur of the following dates:

- (a) Upon expiration of the Consulting Period.
- (b) Upon the death or disability of the Consultant. For purposes of this Agreement, the Consultant shall be deemed disabled if he has been unable to render the services required to be rendered by him in the Consulting Period for thirty (30) consecutive days.
- (c) At the election of the Company, upon thirty (30) days' prior written notice.

9. *Payments Upon Termination.* If all employment of the Consultant by the Company under this Agreement

is terminated, the Company shall pay the Consultant the compensation otherwise payable to him under Section 7 through the date of such termination.

10. *Miscellaneous.* This Agreement shall inure to the benefit of and be binding upon the Company and the Consultant and their respective successors, executors, administrators, heirs and permitted assigns; *provided* that the Consultant may not make any assignment of this Agreement or any interest therein, by operation of law or otherwise, without the prior written consent of the Company. This Agreement constitutes the entire agreement between the parties and may not be changed except by a writing duly executed and delivered by the Company and the Consultant in the same manner as this Agreement. This Agreement is governed by and shall be construed in accordance with the laws of the State of Washington. The Company and the Consultant may execute this Agreement in any number of counterparts, each of which is an original, but all of which shall constitute but one instrument. In proving this Agreement, it shall not be necessary to produce or account for more than one such counterpart. This Agreement supersedes in all respects any prior agreement between the Company and the Consultant relating to any of the subject matter hereof.

B&D COMPANY, INC.

By \_\_\_\_\_  
SAMUEL S. DENNIS 3d  
Its President

\_\_\_\_\_  
IVAN K. LANDRETH



**EXHIBIT J**  
**TO THE AFFIDAVIT OF SAMUEL S. DENNIS 3D**

The Stock Purchase Agreement dated as of October 6, 1977 together with the exhibits to it is reproduced in full in this Joint Appendix at pages 206 to 263.

**EXHIBIT K**  
**TO THE AFFIDAVIT OF SAMUEL S. DENNIS 3D**

The Agreement Of, And Amendment To, Stock Purchase Agreement, effective November 16, 1977 together with Exhibit H to the Stock Purchase Agreement is reproduced in full in this Joint Appendix at 264 to 274.

**EXHIBIT L**  
**CERTIFICATE**

Ivan K. Landreth, Thomas E. Landreth and Ivan K. Landreth, Jr. (such three individuals, collectively, the "Sellers") and Landreth Timber Company, Inc., a Washington corporation, as they are parties to a Stock Purchase Agreement dated October 6, 1977, as amended on November 16, 1977, among them and Samuel S. Dennis, 3d (such Stock Purchase Agreement, as so amended, the "Stock Purchase Agreement"), hereby jointly and severally certify as follows:

- (1) All of the terms and conditions of the Stock Purchase Agreement to be complied with and performed by the Sellers or by the Company on or before the date of this Certificate have been complied with and performed in all material respects;
- (2) All of the representations and warranties made by the Sellers and by the Company to the Buyer in the Stock Purchase Agreement are true and correct in all material respects as of the date of this Certificate, with the same force and effect as though such representations and warranties had been made as of the date hereof; and
- (3) No adverse change has occurred from and after the date of the Stock Purchase Agreement to and including the date of this Certificate which would materially affect the business, property, financial condition or future prospects of the Company.

IN WITNESS WHEREOF, the Company and the Sellers have hereunto set their respective hands and seals as of this November —, 1977.

LANDRETH TIMBER COMPANY, INC.

By /s/ Ivan K. Landreth  
IVAN K. LANDRETH  
President

/s/ Ivan K. Landreth  
IVAN K. LANDRETH

/s/ Ivan K. Landreth  
IVAN K. LANDRETH  
as Attorney-in-Fact for  
Thomas E. Landreth and  
Ivan K. Landreth, Jr.

**EXHIBIT M**

**ENGST, PHELPS & YOUNG**  
 ATTORNEYS AT LAW  
 6 Fuller-Quigg Bldg.—AC 509/662-7193  
 Wenatchee, Washington 98801

November 17, 1977

B&D Company, Inc.  
 c/o Graham & Dunn  
 34th Floor, Rainier Bank Tower  
 1301 Fifth Avenue  
 Seattle, Washington 98101

Re: Stock Purchase Agreement Dated October 6, 1977,  
 As Amended on November 16, 1977

Gentlemen:

This opinion is rendered to you pursuant to Paragraph 5(c) of the Stock Purchase Agreement dated October 6, 1977, as amended on November 16, 1977 (the "Stock Purchase Agreement"), among B&D Company, Inc. (the "Buyer"), Landreth Timber Company, Inc. (the "Company"), Ivan K. Landreth, Ivan K. Landreth, Jr. and Thomas E. Landreth (such three last-named persons, collectively, the "Sellers").

I am of the following opinion:

1. The Company is duly incorporated under the laws of the State of Washington, has paid all taxes and license and filing fees due to said State and is a corporation in good standing in said State. The Company has all corporate power and authority necessary to own the properties now owned or purported to be owned by it, and to conduct its business as it is presently conducted.

2. The authorized capital stock of the Company consists of 1,000 shares of a single class of \$100 par value common stock ("Common Stock"). The total number of issued and outstanding shares of Common Stock is 500 shares, which shares are held beneficially and of record as follows:

<u>Name of Shareholder</u>	<u>Number of Shares Held Both Beneficially and of Record</u>
Ivan K. Landreth	380
Ivan K. Landreth, Jr.	60
Thomas E. Landreth	60
<b>TOTAL</b>	<b>500</b>

There are no shares of Common Stock reserved for issuance or committed to be issued to anyone for any purpose. There is no restriction whatever on the transfer of the issued and outstanding shares of Common Stock, whether imposed by the Articles of Incorporation or By-Laws of the Company, by any other agreement, document or instrument binding on the Company or the holders of such shares of Common Stock or by any other means.

3. All 500 of the issued and outstanding shares of Common Stock have been duly and validly issued and are fully paid and nonassessable.
4. There are no options, agreements, or commitments of any kind known to me relating to the Common Stock, except as contemplated by the Stock Purchase Agreement.
5. Upon the transfer of all 500 issued and outstanding shares of Common Stock and payment therefor in accordance with the terms of the Stock Purchase Agreement, the Buyer will have good and valid title to all of such shares of Common Stock free of any and all liens, encumbrances, claims or other limitations thereon, and the Buyer will be the "bona fide pur-



chaser" (as such term is defined in the Uniform Commercial Code) of such shares.

6. The Stock Purchase Agreement has been duly and validly executed and delivered by the Sellers and the Company, and is legally and validly binding upon each of them in accordance with its terms. Ivan K. Landreth, the father of Ivan K. Landreth, Jr. and Thomas E. Landreth (both of whom are of legal age and fully competent), has acted as the duly authorized attorney-in-fact for both his sons in connection with the execution and delivery of the Stock Purchase Agreement and the consummation of all transactions contemplated thereby.
7. The execution and delivery of the Stock Purchase Agreement, the transfer of all issued and outstanding shares of Common Stock to the Buyer, the consummation of all other transactions contemplated by the Stock Purchase Agreement in accordance with its terms, and the compliance with the provisions of the Stock Purchase Agreement on the part of the Company and the Sellers will not constitute a violation of any statute or any regulation or conflict with or result in a breach of or default under the Articles of Incorporation or By-Laws of the Company or any of the terms, conditions or provisions of any agreement, document or instrument known to me to which any of the Sellers or the Company is a party or by which any of them is bound.
8. To the best of my knowledge, there is no litigation, proceeding, claim or governmental investigation pending or threatened against, or relating to, the Company or its properties or business.

Very truly yours,

ENGST, PHELPS & YOUNG

/s/ Edward T. Engst  
 EDWARD T. ENGST  
 as Counsel for  
 Landreth Timber Company, Inc.,  
 Ivan K. Landreth,  
 Ivan K. Landreth, Jr., and  
 Thomas E. Landreth

ETE:bf

## EXHIBIT A

IN THE UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

---

No. C78-663SR

LANDRETH TIMBER COMPANY, INC.  
*Plaintiff,*

vs.

IVAN K. LANDRETH, *et al.*,  
*Defendants.*

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Transcript of proceedings in the above-entitled and -numbered cause, before the Honorable Barbara J. Rothstein, United States District Court Judge, on February 27, 1981.

THE COURT: Counsel, let me say this: I am torn between wanting to give you a very carefully reasoned well-written-out decision which I think your briefs merit—I don't know what was before other courts when they ruled on this in terms of their reasoning, but this court certainly is not in a position of in any way pretending the issues don't exist and just making it sound as if the issue was clearly one way or the other, because counsel have clearly zeroed in on the ambiguities in Forman and have made them the central issue in this case.

I think it warrants a well-reasoned answer, but on the other hand I would like to move this along for you and give you an idea of where my thinking is at this point so we can get onto the next hearing.

One thing I would urge both counsel is the last word I would use in discussing the Forman case is "clearly" anything. If anything is clear, it is that word "clearly" does not apply. It is apparent to the court that either by design or just by omission the Forman court was not considering this type of case at the time the decision was rendered. It was dealing with a very peculiar situation. The stock there was clearly not what, by any characteristics, would qualify as commercial stock.

What this court has to decide and what the other courts before it presumably were faced with is the question of was Forman meant to be a kind of unique one-shot situation, or was Forman meant as a precursor and an indicator of what the Supreme Court was thinking in terms of more universally applicable laws in terms of dealing with situations involving the Securities Act.

There is no question that one interpretation of Forman would be to say that it only had to reach the issue before it and find that the characteristics of the stock before it did not qualify that stock as a security and that's all it was saying. But it seems to this court that that is too limited an interpretation to place on the Forman case, and that consequently, whether well reasoned or not, the leanings of the courts that have followed it, at least the circuit courts, have been to see Forman as a precursor of a tendency to look at the Securities Act and interpret what that Act was really meant to cover.

It is clear to this court that the initial intent of the Securities Act, if we go back that far and try to figure it out, was not to cover this type of a situation, that this situation was not the kind of transfer of securities with which the 1933, 1934 Acts were concerned.

And starting with that basic premise, I think this court sees that Forman intended to provide an analysis that would enable courts to more correctly apply the Securities Act in accord with the intent of Congress in designing those Acts.



At this time the court would see that Forman across the board in parts A and B intended to utilize an economic realities test, and while the court did not have to reach a full statement of that in part A of Forman, this case today rather clearly and squarely faces the problem. We can't get by by saying anything about the stock characteristics. There is no question in the court's mind that the characteristics of the stock in this case comply with the general corporate stock characteristics, all 11 of them that counsel have so clearly set out.

So I think you are right, it depends on how the court views Forman, and I do find that the reasoning in the seventh circuit case is persuasive. The courts have interpreted Forman as setting a certain trend and saying the federal courts have jurisdiction when the statute intended them to have jurisdiction. A case that could either have been a transfer of assets or of stock, a 100 percent stock transfer such as we have before us, was not intended to be covered by the Act, and I think Forman indicates that.

Just a word about the Ambrust case, counsel. Ambrust in no way sets precedent for this court. The issue was the question of whether a face to face stock sale transaction was covered by the Securities Act as distinct from an over-the-counter transaction. The court in Ambrust not only didn't have Forman before it, but didn't have this question briefed and argued before it squarely.

I think this clearly raises the control issue, and the briefs have set out, and both counsel agree, that there is a dispute or set of disputed facts. It clearly cannot go by summary judgment, and I think it requires an evidentiary hearing on the control issue, and I would like to set one up and I would like you to do some thinking about how much time you think you need.

Now, let me create some guidelines here. I don't think that the issue of control goes to who was in control of making the representations at the time of the sale. In other words, a lot of the allegations in the affidavits go

to the fact that Landreth clearly was in a position to tell everybody everything, because he was in a position of control and he had the books, the records, the accounting materials. That's not the control we are talking about. I don't want to get into that.

The allegations of fraud, as the court sees it, will be tried in state court. It will save time not to repeat them here.

The issue the court is concerned about is what was the intent of those people who bought that stock. Were they going to take over the running of this corporation? That doesn't mean they have to personally be running it, they could hire somebody to run it, or were they buying the stock with the intent that Mr. Landreth was going to stay on and run this corporation for them in some meaningful activity? I guess that's where the court is going to have to draw some conclusions.

I don't want the hearing to get out of hand into the actual allegations of fraud. With those guidelines, counsel, why don't you see what you are going to be putting on in terms of evidence and call Mr. Kimzey.

I know this matter has been pending a long time, and if you can get your evidence together, I wouldn't mind hearing it next week. I can't imagine this is going to take a great deal of preparation of witnesses. I don't anticipate it being a long hearing.

MR. EDWARDS: Your honor, we might even be able to handle it probably by way of allowing us to make an offer of proof, perhaps a written one, and the court could look at it and decide whether taking those things as true that was sufficient to solve the problem.

THE COURT: That would be an excellent way, counsel, if you can agree. It would almost be by way of stipulating certain facts.

MR. EDWARDS: I don't think they would agree to the facts that we would offer. I think the facts that we would offer would probably give the court the opportunity to exercise its judgment about whether it considers—



THE COURT: Okay.

MR. SMITH: Your honor, I would suggest that I think we can get together on a great number of the facts which bear on this issue that are not in dispute, and if we need a hearing at all, I think it can be quite limited.

THE COURT: I am going to leave it to counsel to notify the clerk as to what you think you need; bearing in mind that I can always ask you for a hearing if when I see the materials I think I need it. I would like to get this as quickly as possible. I don't know if you want to set a scheduling now for the submission of papers, or do you want to discuss it between yourselves or what?

MR. EDWARDS: I would rather we did not schedule. I am really bunched for about the next ten days. This is a matter of great importance and requires some time.

MR. SMITH: We can work it out.

THE COURT: Let me say this, the court is going to be out of town the last two weeks in March. So if you are not going to get me the materials in the next two weeks, don't feel a time pressure. I would certainly like to have them here by the time I return at the end of March. I think that would probably be a reasonable deadline for you to work against.

MR. EDWARDS: Your honor, I would also like to reserve the opportunity to argue the question as to whether the control always must take place after the sale, and our offer of proof will give the facts that I think are relevant in determining the control issue, and as we would point out in our argument, I think the pre-closing control is also critical, not control over representations, but control over developing a system or a machine or a mill that would produce a profit.

MR. SMITH: Your honor, I would just point out that I think that's exactly the concern that the court expressed, because that gets us into the representations, the pre-sale closing activity. If the court deems that relevant, we will certainly present evidence on that.

THE COURT: I can see how that might be relevant in one regard and that is if the allegations are that it was represented that there would be control, the purchase was made relying on that, and then the control didn't actually come through, I could see that situation as being a relevant one in terms of the incentive of the motive behind the purchase. Is that what you meant, Mr. Edwards?

MR. EDWARDS: No, I don't, your honor. Maybe the best thing to do is schedule a time to argue that question, which we have not argued, because I think under Howey and the other cases that control doesn't have to be after the sale, and I would like the opportunity to argue that.

THE COURT: Why don't you try to get the facts together. Let's see what the facts are and I certainly will allow you the time to argue that, but it might be easier for me to understand your argument if I know exactly the factual context you're urging.

I want to thank counsel for the argument and the briefs. They really zeroed in on the question and were extremely helpful to the court. Thank you very much.

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

Civil Action No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

vs.

IVAN K. LANDRETH and LUCILLE LANDRETH, *et al.*,  
*Defendants.*

IVAN K. LANDRETH and LUCILLE LANDRETH,  
husband and wife, *et al.*,  
*Counterclaim Plaintiffs,*

vs.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim Defendants.*

[Filed Mar. 26, 1981]

**DEFENDANTS' REQUESTS TO PLAINTIFF FOR  
ADMISSIONS OF FACT CONCERNING  
POST-CLOSING CORPORATE CONTROL**

TO: Landreth Timber Company, Inc., and its attorney,  
John W. Hathaway, EDWARDS & BARBIERI

Pursuant to Court order and Rule 36 of the Federal  
Rules of Civil Procedure, you are hereby requested to  
admit to or specifically deny the truth of the matters set

forth below on or before March 25, 1981. You are re-  
minded that FRCP 36 requires that "[a] denial shall  
fairly meet the substance of the requested admission,  
and when good faith requires that a party qualify his  
answer or deny only a part of the matter of which an  
admission is requested, he shall specify so much of it  
as is true and qualify or deny the remainder.

**DEFINITIONS**

1. The term "plaintiff" refers to plaintiff/counter-  
claim defendant Landreth Timber Company, Inc.

2. The term "defendants" refers to defendants/  
counterclaim plaintiffs Ivan K. Landreth and Lucille  
Landreth, husband and wife; Thomas E. Landreth; and  
Ivan K. Landreth, Jr. and Kathleen Landreth. Unless  
otherwise indicated, the same "Landreth" or "Ivan Land-  
reth" refers to Ivan K. Landreth.

3. The term "Dennis" refers to Samuel S. Dennis III  
of Newton, Massachusetts, buyer under the Stock Pur-  
chase Agreement dated October 6, 1977.

4. The term "closing" refers to November 17, 1977,  
the date on which the sale of Landreth Timber Company,  
Inc. by defendants to B & D Company, Inc., plaintiff's  
predecessor in interest, was consummated.

**REQUESTS FOR ADMISSIONS**

1. Attached hereto are true, correct, and authentic  
copies of the following documents:

(a) Executed Stock Purchase Agreement dated Octo-  
ber 6, 1977.

(b) Executed Assignment Of, And Amendment To,  
Stock Purchase Agreement dated November 16, 1977.

(c) Executed Articles of Merger of Landreth Timber  
Company, Inc. into B & D Company, Inc. dated Novem-  
ber 17, 1977.

(d) Executed Agreement And Plan of Merger of Landreth Timber Company, Inc. into B & D Company, Inc. dated November 17, 1977.

(e) Executed Resignation of Officers of Landreth Timber Company, Inc. dated November 17, 1977.

(f) Executed Resignation of Directors of Landreth Timber Company, Inc. dated November 17, 1977.

(g) Document numbers 11001969 through 11002041, consisting of stock certificates and related assignments having as their cumulative effect the vesting of ownership of Landreth Timber Company, Inc. stock after November 17, 1977, in Dennis, Lillian W. Dennis, John Bolten, Sr., John Bolten, Jr., Katherine S. Bolten, Jack P. Branch, Robert E. Branch, Al Willard, Isabel Willard, Troy Beaver, Sr., and Troy Beaver, Jr.

(h) Action of Sole Director (Dennis) dated November, 1977 (Document numbers 11002296-97).

(i) Letter from Jack P. Branch to Dennis dated October 20, 1977 with resume attachments (Document numbers 11003155-61; Deposition Exhibit 31).

(j) Letter from Jack Branch to Ivan Landreth dated October 27, 1977 (Document number 41000053-54; Deposition Exhibit 115).

(k) Letter from Jack Branch to Phil Cook dated December 19, 1977 (Document number 11003314; Deposition Exhibit 294).

(l) Certificate of President signed by Dennis and dated November 17, 1977 (Document number 11002330).

(m) Letter from Dennis to Supervisor, Colville National Forest, dated November 17, 1977 (Document number 11002331).

(n) Letter from Jack Strother to Ivan Landreth dated March 3, 1978 (Document number 61000067).

(o) Letter from Ivan Landreth to Jack Strother dated January 16, 1978 (Document number 61000219-21).

(p) Executed Consulting and Noncompetition Agreement effective November 17 (Document numbers 11002177-180).

(q) Letter from Jack Branch to Ivan Landreth dated January 10, 1978 (Deposition Exhibit 298).

(r) Letter from Jack Branch to Dennis and John Bolten dated November 21, 1977 (Document numbers 11003242-43; Deposition Exhibit 285).

(s) Letter from Jack Branch to Dennis and John Bolten dated November 28, 1977 (Document numbers 11003244-45; Deposition Exhibit 286).

(t) Letter from Jack Strother to Phil Cook dated December 1, 1977 (Document number 11004196).

(u) Letter from Dennis to Jack Branch dated December 1, 1977 (Document number 11003257; Deposition Exhibit 287).

(v) Letter from Jack Branch to Dennis and John Bolten dated December 6, 1977 (Document numbers 11003269-71; Deposition Exhibit 288).

(w) Letter from Dennis to Phil Cook dated December 7, 1977 (Document number 11003277; Deposition Exhibit 290).

(x) Letter from Dennis to Phil Cook dated December 7, 1977 (Document numbers 11003274-76; Deposition Exhibit 291).

(y) Letter from Jack Branch to Dennis dated December 12, 1977 (Document numbers 11003282-85; Deposition Exhibit 292).

(z) Letter from Dennis to Phil Cook dated December 13, 1977 (Document number 11003287).



(aa) Letter from Dennis to John Bolten dated December 16, 1977 (Document number 11003296).

(bb) Letter from Jack Branch to Dennis dated December 19, 1977 (Document numbers 11003302-05; Deposition Exhibit 296).

**RESPONSE:**

Admit.

2. As of October 5, 1977, one hundred percent (100%) of the outstanding stock of Landreth Timber Company, Inc. was owned by defendants Ivan K. Landreth, Ivan K. Landreth, Jr., and Thomas E. Landreth.

**RESPONSE:**

Admit.

3. As of October 5, 1977, the most valuable physical asset of Landreth Timber Company, Inc. was a lumber manufacturing facility under reconstruction in Tonasket, Washington.

**RESPONSE:**

Admit.

4. Under the terms of a Stock Purchase Agreement dated October 6, 1977, Ivan K. Landreth, Ivan K. Landreth, Jr., and Thomas E. Landreth, as sellers, agreed to sell one hundred (100%) of the outstanding stock in Landreth Timber Company, Inc. to Samuel S. Dennis III ("Dennis") as buyer.

**RESPONSE:** Deny insofar as request assumes parties contemplated that Dennis executed stock purchase agreement in individual capacity. Admit that, under the terms of the stock purchase agreement, defendants agreed to sell 100% of the outstanding (continued on attached sheet)

5. Closing of the Stock Purchase Agreement occurred on November 17, 1977.

**RESPONSE:**

Admit.

6. Under the terms of an Assignment of, And Amendment To, Stock Purchase Agreement dated November 16, 1977, Dennis assigned his interest in Landreth Timber Company, Inc. to B & D Company, Inc.

**RESPONSE:**

(see answer on attached sheet)

7. B & D Company, Inc. is a Delaware corporation which was formed pursuant to the direction of Dennis, or his business partners or agents.

**RESPONSE:**

(see answer on attached sheet)

8. Under the terms of an Agreement and Plan of Merger dated November 17, 1977, Landreth Timber Company, Inc. was merged into B & D Company, Inc.

**RESPONSE:**

Admit.

9. The merger of Landreth Timber Company, Inc. into B & D Company, Inc. was effected pursuant to the direction of Dennis, or his business partners or agents.

**RESPONSE:**

(see answer on attached sheet)

10. Upon consummation of the merger of Landreth Timber Company, Inc. into B & D Company, Inc., plaintiff thereafter continued to conduct the sawmill business as Landreth Timber Company, Inc.

*RESPONSE:*

Admit.

11. None of the defendants were officers, directors, shareholders, or employees of B & D Company, Inc.; nor did said defendants have any financial interest of any kind in B & D Company, Inc.

*RESPONSE:*

Admit.

12. Prior to closing, the officers of Landreth Timber Company, Inc. consisted of Ivan K. Landreth as President, and Lucille Landreth as Vice-President and Secretary-Treasurer.

*RESPONSE:*

Admit.

13. Prior to closing, the entire Board of Directors of Landreth Timber Company, Inc. consisted of Ivan K. Landreth, Lucille Landreth, and Thomas E. Landreth.

*RESPONSE:*

Admit.

14. Paragraph 4(b)(3) of the Stock Purchase Agreement required the sellers of Landreth Timber Company to deliver to buyer at closing the signed resignations of all officers and directors of the company.

*RESPONSE:*

Admit.

15. At closing on November 17, 1977, Ivan K. Landreth executed a written resignation as president of Landreth Timber Company, and Lucille Landreth executed a written resignation as vice-president and treasurer of the company.

*RESPONSE:*

Admit.

16. At closing on November 17, 1977, Ivan K. Landreth, Lucille Landreth, and Thomas E. Landreth resigned as directors of Landreth Timber Company.

*RESPONSE:*

Admit.

17. Prior to November 17, 1977, Dennis assembled a group of individuals to hold stock in Landreth Timber Company after closing of the sale; none of the defendants were included in this group.

*RESPONSE:* Deny that Dennis assembled the purchasing group. Admit that defendants purchased no shares in B & D Company, Inc. or in the successor Landreth Timber Co., Inc.

18. After closing on November 17, 1977, two classes of Landreth Timber Company stock existed. Class A stock was owned by Dennis, Lillian W. Dennis, John Bolten, Sr., John Bolten, Jr., and Katherine S. Bolten. Class B stock was owned by Jack P. Branch, Robert E. Branch, Al Willard, Isabel Willard, Troy Beaver, Sr., and Troy Beaver, Jr.

*RESPONSE:*

Admit.

19. After closing, none of the defendants were officers, directors, or shareholders in Landreth Timber Company.

*RESPONSE:*

Admit.

20. After closing, none of the defendants retained any ownership interest in Landreth Timber Company.

**RESPONSE:** Admit that defendants had no stock ownership interest in Landreth Timber Company after closing.

21. After closing, none of the defendants had any right to share in profits or losses of Landreth Timber Company.

**RESPONSE:**

(see answer on attached sheet)

22. After closing, none of the defendants, other than Ivan Landreth, had any employment relationship with Landreth Timber Company or were involved in any respect with the operation of the company.

**RESPONSE:**

Admit.

23. Immediately after closing, the board of directors of Landreth Timber Company consisted of Dennis and John Bolten, Sr.

**RESPONSE:**

Admit.

24. Immediately after closing, the officers of Landreth Timber Company consisted of John Bolten, Sr., chairman of the board; Dennis, president and treasurer; Jack G. Strother, secretary; and Ruth A. Weymouth, assistant secretary.

**RESPONSE:**

Admit.

25. Prior to closing, Jack Branch began searching for a General Manager to replace Ivan Landreth after closing.

**RESPONSE:** Admit that Jack Branch began searching for a general manager prior to closing. Deny that the general manager was to replace Ivan Landreth.

26. Jack Branch was acting on behalf of Dennis in attempting to locate a General Manager.

**RESPONSE:** Deny that Jack Branch was acting on behalf of Dennis in attempting to locate a general manager. Admit that Jack Branch acted on behalf of purchasers.

27. By letter dated October 20, 1977, Jack Branch advised Dennis that his search for a new General Manager had narrowed to three candidates, one of which was Phil Cook.

**RESPONSE:**

Admit.

28. Between October 20, 1977 and closing on November 17, 1977, Dennis' purchasing group selected and retained Phil Cook to be General Manager of Landreth Timber Company after closing.

**RESPONSE:**

Admit.

29. Prior to closing, Landreth provided the purchasers with the name of an individual he recommended as a possible general manager. This individual was not Phil Cook.

**RESPONSE:**

(see answer on attached sheet)

30. Ivan Landreth did not in fact participate in the decision to hire Phil Cook as General Manager.



**RESPONSE:**

(see answer on attached sheet)

31. By letter dated October 27, 1977, Jack Branch informed Ivan Landreth that Phil Cook had been hired to be the new General Manager after closing, and requested that Landreth extend "all courtesies to Phil in any interim meetings that you will have with him prior to our formal take over" after closing.

**RESPONSE:**

Admit.

32. After closing, Phil Cook immediately assumed the position of General Manager of Landreth Timber Company operations.

**RESPONSE:**

Admit.

33. Ivan Landreth's role with Landreth Timber Company after closing was as a consultant pursuant to the terms of a Consulting and Non-Competition Agreement dated November 17, 1977.

**RESPONSE:**

Admit.

34. Ivan Landreth had no job title with Landreth Timber Company after closing.

**RESPONSE:**

Deny.

35. The nature and scope of Ivan Landreth's post-closing role as consultant were defined by paragraph 1.2 of the Consulting Agreement, to wit:

1.2. *Consulting Duties, etc.* The Company shall employ the Consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the Consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as a consultant to the Company in connection with such participation and for such purposes.

**RESPONSE:**

Admit.

36. Ivan Landreth's compensation as a consultant was on a fixed monthly salary plus expenses with no profit sharing, commissions, or other components.

**RESPONSE:**

Admit.

37. Paragraph 2.2 of the Consulting Agreement defined the circumstances under which Landreth Timber Company would reimburse Ivan Landreth for expenses incurred by him in his role as a consultant, to wit:

2.2 *Reimbursement of Costs and Expenses.* Consultant will be reimbursed for his reasonable costs and expenses in connection with the performance of services specifically requested by the Company upon reasonable substantiation and approval by the Company of such costs and expenses.

**RESPONSE:**

Admit.

38. Paragraph 8(c) of the Consulting Agreement provided that Ivan Landreth's post-closing employment was terminable by plaintiff at will upon thirty days prior written notice.

**RESPONSE:**

Admit.

39. After closing, Jack Branch monitored construction progress and operations at the mill, and reported periodically to Dennis and Bolten concerning the same.

**RESPONSE:**

(see answer on attached sheet)

40. By letter dated November 21, 1977, Jack Branch reported to Dennis and Bolten concerning certain events related to "the transition" during the first several days after closing, stating among other things:

"[I]t was very gratifying to see a take-charge guy like Phil Cook showing his real leadership capabilities and literally snapping them [the employees] to and starting to run the show like a real business. I do feel you can be proud of Phil Cook and his business-like manner and overall leadership."

**RESPONSE:**

(see answer on attached sheet)

41. Two days after closing, Phil Cook excluded Ivan Landreth from a meeting with representatives of Warren & Brewster, the maxi-mill supplier.

**RESPONSE:**

Deny.

42. After closing, Landreth Timber Company and Phil Cook possessed the authority to hire or fire employees without the permission or concurrence of Ivan Landreth.

**RESPONSE:**

Admit.

43. After closing, Ivan Landreth did not possess the authority to hire or fire employees without the permission or concurrence of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

44. After closing, Ivan Landreth did not in fact hire or fire any Landreth Timber Company employees.

**RESPONSE:**

Admit.

45. After closing, Landreth Timber Company possessed the authority to set or change employee salary levels without the permission or concurrence of Ivan Landreth.

**RESPONSE:**

Admit.

46. After closing, Ivan Landreth did not possess the authority to set or change employee salary levels without the permission or concurrence of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

47. After closing, Ivan Landreth did not in fact set or change any salary levels for Landreth Timber Company employees.

**RESPONSE:**

Admit.

48. After closing, Phil Cook possessed the authority to enter into new timber purchase contracts without the permission or concurrence of Ivan Landreth.

**RESPONSE:**

Admit.

49. After closing, Ivan Landreth did not possess the authority to enter into new timber purchase contracts without the permission or concurrence of Landreth Timber Company or Phil Cook.

**RESPONSE:**

Admit.

50. After closing, Ivan Landreth did not in fact enter into any new timber purchase contracts on behalf of Landreth Timber Company.

**RESPONSE:** Admit that defendant Landreth signed no such contracts. Deny that defendant Landreth did not participate in bidding on, and acquiring, such contracts on behalf of plaintiff.

51. Prior to closing, Landreth Timber Company purchased timber from the United States Forest Service.

**RESPONSE:**

Admit.

52. Paragraph 2(j) of the Stock Purchase Agreement stated that Landreth Timber Company had in the past purchased "most" of its timber requirements from the Forest Service.

**RESPONSE:**

Admit.

53. By letter dated November 17, 1977, Dennis informed the Forest Service that Landreth Timber Company had been sold to a new purchasing group, that Dennis was the controlling stockholder and that Phil Cook was "the new General Manager of all operations at Landreth Timber Company."

**RESPONSE:**

Admit.

54. By an instrument entitled "Certificate of President" dated November 17, 1977, Dennis attested that the following resolution was adopted by all of the new directors of Landreth Timber Company:

**RESOLVED:** That Phillip A. Cook, as General Manager of the Company's operations, is hereby designated and authorized as the Company's representative to deal with the United States Forest Service and to execute all documents in connection with timber cutting contracts and any and all matters between Forest Service and the Company.

**RESPONSE:**

Admit.

55. After closing, Landreth Timber Company and Phil Cook possessed the authority to make decisions for Landreth Timber Company concerning product mix, product sales, and sale terms without the permission or concurrence of Ivan Landreth.



*RESPONSE:*

(see answer on attached sheet)

56. After closing, Ivan Landreth did not possess the authority to make decisions for Landreth Timber Company concerning product mix, product sale prices, or sale terms without the permission or concurrence of Landreth Timber Company or Phil Cook.

*RESPONSE:*

Admit.

57. After closing, Ivan Landreth did not in fact make or implement any decisions for Landreth Timber Company concerning product mix, product sale prices, or sale terms on behalf of Landreth Timber Company.

*RESPONSE:*

Deny.

58. After closing, Landreth Timber Company and Phil Cook possessed the authority to make decisions concerning expenditures for equipment acquisitions and maintenance without the permission or concurrence of Ivan Landreth.

*RESPONSE:* Deny that Cook was not required to confer with defendant Landreth concerning expenditures for equipment acquisitions and maintenance. Admit that, after conferring with defendant Landreth, Cook was authorized to make these decisions on behalf of plaintiff.

59. After closing, Ivan Landreth did not possess the authority to make decisions for Landreth Timber Company concerning expenditures for equipment acquisitions and maintenance without the permission or authority of Landreth Timber Company or Phil Cook.

*RESPONSE:*

Admit.

60. After closing, Ivan Landreth did not in fact make or implement any decisions for Landreth Timber Company concerning expenditures for equipment acquisitions or maintenance.

*RESPONSE:*

Deny.

61. After closing, Landreth Timber Company and Phil Cook possessed the authority to make decisions concerning construction, design, or redesign of the sawmill without the permission or concurrence of Ivan Landreth.

*RESPONSE:* Deny that Cook was not required to confer with defendant Landreth concerning construction and design of the facility. Admit that, after conferring with defendant Landreth, Cook was authorized to make these decisions on behalf of the plaintiff.

62. After closing, Ivan Landreth did not possess the authority to make decisions for Landreth Timber Company concerning construction, design, or redesign of the sawmill without the permission or concurrence of Landreth Timber Company or Phil Cook.

*RESPONSE:*

Admit.

63. After closing, Ivan Landreth did not in fact make or implement any decisions for Landreth Timber Company concerning construction, design, or redesign of the sawmill.

*RESPONSE:*

Deny.

64. By letter dated December 7, 1977 (Deposition Exhibit 290) Dennis communicated with Phil Cook concerning product mix policy and the potential advisability of purchasing a new kiln.

**RESPONSE:**

Admit.

65. Dennis sent copies of the letter which is Deposition Exhibit 290 to John Bolten, Jack Branch, Peter Townsend, Thomas Wood, and Frederick Fritz, but not to Ivan Landreth.

**RESPONSE:**

Admit.

66. By a second letter dated December 7, 1977 (Deposition Exhibit 291) Dennis communicated with Phil Cook concerning product pricing policy.

**RESPONSE:**

Admit.

67. Dennis sent copies of the letter which is Deposition Exhibit 291 to John Bolten, Jack Branch, Peter Townsend, Thomas Wood, and Frederick Fritz, but not to Ivan Landreth.

**RESPONSE:**

Admit.

68. By letter dated December 19, 1977 (Deposition Exhibit 294), Jack Branch advised Phil Cook of Ivan Landreth's post-closing role at the mill, stating, among other things:

"Ivan Landreth and his sons have sold 100% of the stock of Landreth Timber Company to B & D Corporation which subsequently will change its name

back to Landreth Timber Company. Ivan Landreth has no stock whatsoever in the company and has been retained on an interim basis for perhaps one to three months as a consultant on matters relating to the orderly transition in sales, contracts, customers, etc. In the event any of your personnel have any vague notions or concerns as to whether Ivan is still involved in the company, please be sure that he is not and although he is still around the mill, more or less tying upon his affairs, we will have no further use for his services in a short period of time. . . . Should you have the need to show this letter to any interested party, please feel free to do so."

**RESPONSE:**

(see answer on attached sheet)

69. Jack Branch sent copies of the letter which is Deposition Exhibit 294 to Sam Dennis and John Bolten.

**RESPONSE:**

Admit.

70. Neither Sam Dennis nor John Bolten ever advised Ivan Landreth, Jack Branch, or Phil Cook that the characterization in Deposition Exhibit 294 of Ivan Landreth's role was inaccurate in any respect.

**RESPONSE:**

Deny.

71. Subsequent to closing, Ivan Landreth received no instructions from Dennis concerning Ivan Landreth's role as a consultant.

**RESPONSE:**

Deny.

72. After closing, Ivan Landreth was not allowed to sign checks on behalf of Landreth Timber Company.

**RESPONSE:**

Admit.

73. After closing, Ivan Landreth was not allowed the use of Landreth Timber Company credit cards.

**RESPONSE:** Admit that defendant Landreth was not allowed the personal use of Landreth Timber Company credit cards. Admit that pursuant to consulting agreement, defendant Landreth was entitled to reimbursement for expenses.

74. After closing, Ivan Landreth's preclosing plans for construction of a timber kickout next to the Helle mill were not completed.

**RESPONSE:** Admit that plaintiff did not complete construction of a timber kickout next to the Helle mill, but deny that plaintiff did not intend to complete construction of the timber kickout.

75. After closing, Ivan Landreth's plans to build up slide guides on the mill's Nicholson 43-inch debarker were not completed.

**RESPONSE:** Admit that the Nicholson 43-inch debarker was completely replaced and building up slide guides on it was therefore not necessary.

76. After closing, Ivan Landreth's plan to install an automatic centering device on the 43-inch Nicholson debarker was not completed.

**RESPONSE:** Admit that the Nicholson 43-inch debarker was completely replaced and installing a centering device was therefore unnecessary.

77. After closing, Ivan Landreth's plan to install a swing-cutoff saw on line in front of the 43-inch Nicholson debarker was not completed.

**RESPONSE:** Admit that the Nicholson 43-inch debarker was completely replaced and that installing a swing-cutoff saw on line in front of it was therefore unnecessary.

78. After closing, Ivan Landreth's plan to install a larger hydraulic tank on the Nicholson 43-inch debarker was not completed.

**RESPONSE:** Admit that the Nicholson 43-inch debarker was completely replaced and that installing a larger hydraulic tank on it was therefore unnecessary.

79. After closing, Ivan Landreth's plan to replace U-shaped Helle-mill wheels and rails with V-shaped wheels and rails was not completed.

**RESPONSE:** Admit that replacement of the U-shaped Helle mill wheels and rails was not completed, but deny that plaintiff did not intend to replace them with V-shaped wheels and rails.

80. After closing, Ivan Landreth's plan to install a conveyor to return boards from the resaw to the edger was not completed.

**RESPONSE:** Admit that the conveyor return from the resaw to the edge was not completed, but deny that plaintiff did not intend to complete it.

81. After closing, plaintiff and/or Phil Cook decided to remove the Filer & Stowell edger which was on site at the time of closing.

**RESPONSE:**

Admit.

82. Ivan Landreth was not asked by plaintiff or Phil Cook to approve or disapprove of the decision to remove the Filer & Stowell edger.



**RESPONSE:**

Deny.

83. After closing, plaintiff and/or Phil Cook decided to replace the Filer & Stowell edger with a used Klamath Ward Mark 50 edger.

**RESPONSE:**

Admit.

84. Ivan Landreth was not asked by plaintiff or Phil Cook to approve or disapprove of the decision to purchase the Klamath Ward Mark 50 edger.

**RESPONSE:**

Deny.

85. On December 28, 1977, Phil Cook purchased a 26 inch debarker for installation at the mill.

**RESPONSE:**

Admit.

86. Ivan Landreth was not asked by plaintiff or Phil Cook to approve or disapprove of the decision to purchase the second debarker.

**RESPONSE:**

Deny.

87. Ivan Landreth was entirely absent from the mill from December 27, 1977 to January 10, 1978.

**RESPONSE:** Plaintiff does not know the exact dates that defendant Landreth was absent from the facility. Plaintiff admits that defendant Landreth was absent from the facility for approximately fifteen to twenty days in late December 1977 and early January 1978.

88. After closing, Ivan Landreth did not retain control over the essential managerial efforts and decisions upon which the failure or success of Landreth Timber Company rested.

**RESPONSE:**

Deny.

89. After closing, control over the essential managerial efforts and decisions affecting the failure or success of the Landreth Timber Company rested with the new officers, directors, shareholders, and General Manager of the company.

**RESPONSE:**

Deny.

90. By letter dated January 10, 1978 Jack Branch notified Ivan Landreth that his employment as a consultant was being terminated.

**RESPONSE:**

Admit.

91. After termination, Ivan Landreth received no compensation of any kind, other than wages up to the date of termination and 30 days severance pay, from Landreth Timber Company.

**RESPONSE:**

Admit.

92. Subsequent to January 10, 1978, Ivan Landreth did not participate in any way in the management or operation of Landreth Timber Company.

**RESPONSE:**

Admit.

93. Between November 17, 1977, and January 10, 1978, Ivan Landreth had no communications with Dennis in any way relating to the management, operation or control of Landreth Timber Company.

**RESPONSE:**

Deny.

94. Between November 17, 1977 and January 10, 1978, Ivan Landreth had no communications with Jack P. Branch in any way relating to the management, operation or control of Landreth Timber Company.

**RESPONSE:**

Deny.

95. Between November 17, 1977, and January 10, 1978, Ivan Landreth had no communications with any officer or director of Landreth Timber Company.

**RESPONSE:**

Deny.

Dated this 20th day of March, 1981.

BOGLE & GATES

/s/ Richard D. Vogt  
JAMES A. SMITH, JR.  
GUY P. MICHELSON  
PATRICIA H. CHAR  
RICHARD D. VOGT  
Attorneys for Defendants

Responses to the foregoing Requests for Admissions of Fact submitted this 26th day of March, 1981.

EDWARDS & BARBIERI

/s/ John W. Hathaway  
MALCOLM EDWARDS  
JOHN W. HATHAWAY  
Attorneys for Plaintiff

CONTINUATION OF ANSWERS TO  
REQUESTS FOR ADMISSIONS

4. stock in Landreth Timber Company to a corporation to be formed by purchasers and that Dennis executed the stock purchase agreement as an accommodation buyer on behalf of the corporation to be formed.
6. Admit that B & D Company was substituted for Dennis as buyer under the stock purchase agreement as stated in paragraph 2 of the Assignment of, and Amendment to, stock purchase agreement and as contemplated by paragraph 3 of the stock purchase agreement.
7. Deny that Dennis was solely responsible for formation of B & D Company. Admit that B & D Company was a corporation formed by the purchasing group, solely for federal tax reasons, to purchase defendant's stock.
9. Deny that the merger of Landreth Timber Company into B & D Company was effected solely at Dennis' direction. Admit that the merger of Landreth Timber Company, Inc. and B & D Company was effected for the benefit of all shareholders of B & D Company in order to establish purchaser's property tax basis in assets of Landreth Timber Company.
21. Admit that, after closing, defendants had no stock right that would have entitled them to dividends or any share in the profits or losses of the corporation. Deny that defendants had no interest in, or obligations concerning, the profits and losses of the Landreth Timber Company.
29. Admit that defendant Landreth provided Jack Branch with the name of a person to be considered for the general manager position. Admit that this person was not Phil Cook. Deny that defendant Landreth recommended that purchasers hire this person.

30. Admit that purchasers, not Ivan Landreth, decided to retain Phil Cook as general manager and that Ivan Landreth was not part of this decision. Deny that defendant Landreth was not asked to participate and cooperate in the search for a general manager and deny that defendant Landreth did not participate in this search.
39. Deny that Branch had any duty or function as a corporate officer to oversee construction progress and operations at the mill. Admit that Branch did visit the mill periodically after closing and that he did communicate his observations to Dennis and Bolten.
40. Deny that Branch had any official corporate oversight function. Admit that Branch's November 21, 1977 letter contained the quote stated. From information known or readily available to plaintiff, plaintiff cannot admit or deny the veracity of the quote.
55. Deny that Cook was not required to confer with defendant Landreth concerning decisions on product mix, product sales, and sale terms. Admit that, after conferring with defendant Landreth, Cook was authorized to make these decisions on behalf of plaintiff.
68. Admit that Branch made these statements in the December 19, 1977 letter to Phil Cook. Deny that these statements constituted advice to Cook concerning defendant Landreth's post-closing role at the mill and deny that these statements accurately describe defendant Landreth's post-closing role at the mill.



### STOCK PURCHASE AGREEMENT

This is an Agreement between IVAN K. LANDRETH of Oroville, Washington, THOMAS E. LANDRETH of Irvine, California, and IVAN K. LANDRETH, JR., of Oroville, Washington ("Sellers"); LANDRETH TIMBER COMPANY, INC., a Washington corporation with its principal office in Tonasket, Washington (the "Company"), and SAMUEL S. DENNIS 3d of Newton, Massachusetts ("Buyer").

WHEREAS, Sellers own five hundred (500) shares of common stock of the Company, being all of the issued and outstanding stock of any class of the Company, and

WHEREAS, Sellers desire to sell and Buyer desires to buy said shares subject to the terms, conditions and provisions hereinafter set forth.

NOW, THEREFORE, the parties agree as follows:

1. Sellers agree to sell and Buyer agrees to buy said shares for a total price of Three Million Four Hundred Thousand Dollars (\$3,400,000), payable as follows:

(a) One Hundred Sixty-Five Thousand Dollars (\$165,000) in cash upon the execution and delivery of fully-executed copies of the agreement to the respective parties. Said down-payment shall be held in escrow by Rainier National Bank, Seattle, Washington (the "Bank") and, subject to the provisions of Paragraph 4 hereinafter, delivered to Sellers at the Closing; provided, that upon the request of Ivan K. Landreth, the Bank shall advance to the Company such amounts from said escrow cash as Mr. Landreth requests for use in conducting the business until the Closing. Said amounts shall constitute a non-interest bearing, unsecured demand loan to the Company from Buyer and shall not reduce the obligation of Buyer to pay the full purchase price not later than February 10, 1978, as hereinafter provided; and

(b) Seven Hundred Fifty Thousand Dollars (\$750,000) cash (including the balance of the \$165,000 deposit pro-

vided in Paragraph 1(a)) to be paid at Closing as provided in Paragraph 4. A note secured by a first mortgage on certain assets of the Company payable to the Small Business Administration amounting to \$253,095 on August 31, 1977 and notes payable to banks secured by a second mortgage on certain property of the Company or by personal collateral of Ivan K. Landreth in the total principal amount of One Hundred Fifty Thousand Dollars (\$150,000) shall be caused to be paid by Buyer at the Closing. An irrevocable written commitment of The First National Bank of Boston and/or Rainier National Bank to pay the cash balance due Sellers on February 10, 1978 shall be delivered to Sellers at the Closing. Said commitment shall be subject to the provisions of this Agreement and in a form satisfactory to counsel for said banks and counsel for Sellers.

(c) Sellers shall at the Closing deliver the shares of the Company to be sold under this Agreement to Buyer, properly endorsed for transfer with signatures guaranteed.

(d) The balance of the total purchase price of Three Million Four Hundred Thousand Dollars (\$3,400,000) in the amount of Two Million Six Hundred Fifty Thousand Dollars (\$2,650,000) shall be paid as follows: One Million Seven Hundred Fifty Thousand Dollars (\$1,750,000) in cash on February 10, 1978 without interest and a note or notes of the Substituted Buyer delivered to Sellers on Closing totaling Nine Hundred Thousand Dollars (\$900,000), payable on or before December 31, 1979. Principal payments on said note shall be at the rate of Thirty Dollars (\$30) per 1,000 feet of timber purchased by the Company beginning nine (9) months after said Maximill is in substantially full operation, as reasonably determined by Ivan Landreth, payable to Sellers at the same time Buyer pays the Sellers of said timber, measured according to the so-called "Standard Scribner Scale" as presently used.

Interest at the annual rate of ten percent (10%) from the date of Closing shall be paid on the average unpaid balance of said \$900,000 note semi-annually beginning six (6) months after the date of said note, computed over the proceeding six-month period. Said note shall be in the form attached hereto marked Exhibit "A" and shall be secured by a second mortgage on the plant and equipment of the Company in a form satisfactory to Rainier National Bank and Sellers' attorney. Said note and mortgage shall be subordinate only to:

(a) Bank and institutional debt of the Company incurred from time to time;

(b) Debt incurred to finance the purchase of the timber by the Company in the ordinary course of business;

(c) Pre-existing liens;

(4) Debt incurred from time to time in connection with equipment lease—purchase financing and similar financing of machinery and equipment incurred in the ordinary course of business. The subordination provisions of said note shall be acceptable to the Bank.

Buyer agrees to arrange necessary guarantees, if any, to secure government contracts for the purchase of timber on a deferred payment basis.

2. Sellers and the Company hereby jointly and severally warrant and represent as follows:

(a) The stock to be delivered to the Buyer represents all of the issued and outstanding capital stock of any class of the Company and there as no shares reserved for issue or committed to be issued to anyone for any purpose. Said five hundred (500) shares are owned by the three Sellers as follows:

Ivan K. Landreth	380 shares
Ivan K. Landreth, Jr.	60 shares
Thomas E. Landreth	60 shares
Total shares issued and outstanding:	<u>500 shares</u>

Said shares are validly issued, fully paid and non-assessable, and Sellers have clear and unencumbered title to said shares. There are no applicable restrictions, agreements or other facts which would prevent each Seller from delivering free and unencumbered title to said shares at the Closing.

(b) This Agreement has been duly-executed by each of the Sellers and the execution and performance of this Agreement by them and by the Company will not violate or result in a breach of or constitute a default under any agreement, instrument, judgment, order or decree nor will it constitute a violation of or conflict with any fiduciary duty of any Seller.

(c) None of the Sellers nor any member of his family has any claim or claims against the Company and the Company is not obligated or liable to any such persons in any way or for any amounts except unpaid salaries or other compensation incurred in the ordinary course of business and disclosed to the Buyer in the financial statements attached hereto and an unsecured note in the amount of Twenty Thousand Dollars (\$20,000), payable to Sellers.

(d) None of the Sellers owns any interest or profit participation in outside business enterprises which may be competitive with the Company, and each agrees that he will not own directly or indirectly any interest in or engage in any such business which may be competitive with the Company for a period of five (5) years from the final Closing.

(e) Sellers have employed a broker in connection with this transaction who will look only to the Sellers for a



brokerage commission or other compensation in connection therewith and Buyer shall not be liable for any such commissions or other compensation.

(f) The balance sheet, operating statements and other financial information concerning the Company attached hereto as Exhibit "B" are true and correct, fairly represent the financial condition of the Company, its assets, liabilities and results of operations for the periods covered and such statements are prepared in accordance with generally-accepted accounting principles applied on a basis consistent with prior periods. There are no material liabilities, obligations or commitments of the Company of any nature not appearing on said financial statements or in the footnotes thereto, including, but not limited to, supply contracts in excess of Five Thousand Dollars (\$5,000) in each case, contracts for the purchase of equipment, contracts or commitments for present or deferred compensation, and any other such contracts or commitments, except as set forth in Exhibit "B-1" attached hereto.

(g) The physical assets of the Company consist of an integrated lumber manufacturing facility in Tonasket, Washington, including a new "Maximill" presently nearing completion, lumber-drying facilities consisting of a single 80' four-track kiln with an average holding capacity of about 210,000 FBM and maximum capacity of about 250,000 FBM, a new office building, a planer building, new sorting shed, maintenance shop, a metal sawmill building under construction and a log-handling and debarking facility, including machinery, vehicles and equipment capable of cutting and transporting logs as itemized in Exhibit "C" attached hereto. Construction of the Maximill and related facilities are presently on schedule with a scheduled completion date of about November 30, 1977. This mill is being constructed with first-quality and suitable equipment in a workmanlike manner and, on information and belief, Sellers state that

the mill upon completion, if properly operated, will produce an overrun of at least fifty percent (50%) of the presently accepted so-called "Standard Scribner Scale" for measuring logs. The other equipment presently used in the operation of the mill is suitable for the purpose and in good operating condition, normal wear and tear excepted.

(h) No distributions of money or assets of the Company and no other transactions except in the usual course of business have taken place since the date of the attached balance sheet and none will take place prior to the Closing. No additional debt will be incurred prior to the Closing (other than in the usual course of business) without the prior written consent of the Buyer. The term "usual course of business" includes the purchase of timber appropriate in the opinion of Ivan Landreth for the proper conduct of the business on a continuing basis, having in mind the anticipated production capacity of the plant upon completion of the "Maximill."

(i) The Company has timely filed all required state, federal and other tax returns required by law; all such returns are proper and all taxes shown to be due and all additional assessments have been paid. The federal income tax returns have been audited by the Internal Revenue Service through the taxable year 1975. The attached balance sheet (Exhibit "B") adequately reflects all the proper accruals for tax liabilities reflecting operations to the date of this Agreement.

(j) The Company has in the past purchased most of its requirements for timber from SBA/U.S. FOREST SERVICE ("SBA"), a government agency which sells timber from Okanogan National Forest and Colville National Forest. Presently, twenty-seven percent (27%) of Okanogan National Forest timber sales and forty-four percent (44%) of such sales from Coleville National



Forest are set aside for SBA sales under current government regulations and procedures. Sellers and Company know of no impending change in said policies and procedures or of any other fact which would adversely affect the mill's ability to obtain an adequate supply of timber. The Company has contracts to purchase approximately 27 million bd. ft. of timber from SBA and presently has cut logs either in the forest or at the plant of approximately 3 million bd. ft. of timber based on the Standard Scribner Scale. Attached hereto as Exhibit "D" is a list of all material contracts for the purchase of timber.

(k) The principal customers of the Company consist of laminating mills and wholesale lumber dealers. Attached hereto as Exhibit "E" is a list of the principal customers to whom the Company has sold products in the past three (3) years.

(l) The Company has clear and marketable title to all of its real and personal property and assets of every type and description free and clear of all mortgages, liens, pledges or other charges or encumbrances of any kind except as set forth in the attached balance sheet and footnotes thereto. All of the properties and assets of the Company are in its possession and conform to all applicable laws, rules and regulations; there are no zoning or other restrictions on any real property owned by it which would adversely affect the effective use of such property in the conduct of its business.

(m) The Company has no contracts with any union and operates on a non-union basis. Sellers and Company know of no impending attempt to unionize the Company.

(n) The Company will have at the Closing a binder for valid fire insurance coverage in a form usual to this type of business in a total amount equal to the full insurable value of the major components of the integrated mill.

(o) There is no litigation, proceeding, claim or governmental investigation pending or threatened against, or relating to, the Company or its properties or business, other than as set forth in Exhibit "G" hereto.

### 3. Buyer warrants and represents as follows:

(a) He is an individual residing at 52 Essex Road, Newton, Massachusetts, 02167, and is under no disability to enter into this Agreement and may lawfully carry out its provisions under all applicable laws and regulations.

(b) It is contemplated that a corporation ("Substituted Buyer") will be organized for the purpose of carrying out this transaction. Said corporation will be validly organized and existing and will have all the power and authority necessary to carry out and perform this Agreement. Upon its formation, Buyer will assign all of his rights and obligations in and to this Agreement to said corporation and thereupon said corporation will be substituted as the Buyer with the same legal effect as though it had been the original party to this Agreement.

(c) Said corporation will take all proper legal steps to lawfully perform and carry out this Agreement, including qualifying to do business in the State of Washington and such other jurisdictions as may be necessary in the opinion of Buyer. It is contemplated that immediately upon the acquisition of the stock of the Company by the corporate Buyer, Landreth Timber Company, Inc. will be liquidated into said corporation and the name of said corporation changed to Landreth Timber Co., Inc. Sellers and the Company agree to take all action required by Buyer which in the opinion of Buyer is necessary or appropriate to carry out the above plan.

4. (a) The Closing of this transaction shall take place on November 4, 1977, at the office of Graham, McCord & Dunn, Seattle, Washington, or at a time and place otherwise mutually agreed upon between the parties. All the

conditions precedent to Closing as hereinafter set forth shall have been complied with by the parties on or before the date of Closing.

(b) At the Closing, Sellers shall deliver or cause to be delivered to Buyer the following:

(1) All certificates of stock of the Company, properly endorsed for transfer to Buyer with signatures guaranteed.

(2) The Company's minute book, stock book and all other books and records of the Company.

(3) The signed resignations of all officers and directors of the Company.

(4) A consulting contract in the form attached hereto as Exhibit "F" between the Company and Ivan K. Landreth ("Landreth") for a period of one (1) year at the agreed compensation of Two Thousand Five Hundred Dollars (\$2,500) per month for the first six (6) months and One Thousand Dollars (\$1,000) per month for the last six (6) months. Landreth shall perform such services as are necessary and appropriate to operate the mill during said first six-month period at such times as may be mutually convenient to the parties. During the second six-month period, Landreth shall act as a consultant to the Company at such times and in such capacity as the Company may reasonably request, having regard to Landreth's health and then place of residence.

(c) At Closing, Buyer shall deliver or cause to be delivered to Sellers the following:

(1) Seven Hundred and Fifty Thousand Dollars (\$750,000) cash, which shall include such portion of the One Hundred Sixty-Five Thousand Dollars (\$165,000) deposited under Paragraph 1(a) which has not been loaned to the Company as therein provided.

(2) A subordinated note (Exhibit "A") duly-executed and delivered to Sellers in the amount of Nine Hundred Thousand Dollars (\$900,000), together with a second mortgage or deed of trust securing said note.

(3) A letter of commitment from Rainier National Bank to Sellers as provided in Paragraph 1(b).

5. *Conditions Precedent to the Closing.* All obligations of the parties under this Agreement are subject to the fulfillment prior to or at the Closing of each of the following conditions;

(a) All of the agreements and covenants contained in this Agreement that are to be complied with, satisfied and performed by the respective parties on or before the Closing shall, in all material respects, have been complied with, satisfied and performed.

(b) All of the representations and warranties made by Sellers to Buyer and by Buyer to Sellers in this Agreement or any document furnished or to be furnished by any of them hereunder shall be true and correct in all material respects both on and as of the date of this Agreement and on and as of the date of the Closing.

(c) Buyer shall have received from counsel for Sellers a written opinion dated as of the Closing, addressed to Buyer and satisfactory to Buyer's counsel in form and substance to the effect:

(1) That the corporate existence, good standing under the laws of the state of its incorporation and the authorized and issued stock of the Company are as stated in Paragraph 2 of this Agreement and that neither the Articles of Incorporation nor the By-Laws of the Company (including any amendments thereof) impose any restriction on the transfer by the Sellers of their shares as provided herein.



(2) That the outstanding shares of stock of the Company have been duly and validly issued and are fully paid and non-assessable.

(3) That this Agreement has been duly-executed and delivered by the Sellers and is legally and validly binding on them in accordance with its terms.

(4) That the execution and delivery of this Agreement, the transfer of said shares to Buyer, the consummation of the transactions herein contemplated and compliance with the terms and provisions of this Agreement on the part of the Sellers will not breach any statute or any regulation or conflict with, or result in a breach of the Articles of Incorporation or By-Laws of the Company or any of the terms, conditions or provisions of any agreement or instrument known to said counsel to which any of the Sellers or the Company is a party or is bound.

(5) That there are no options, agreements or commitments of any kind, relating to the capital stock of the Company to which the Company or Sellers are parties.

(6) That, to the best of his knowledge, there is no litigation, proceeding, claim or governmental investigation pending or threatened against, or relating to, the Company or its properties or business, other than as set forth in Exhibit "G."

(7) That, upon the transfer of the stock of the Company and payment therefor in accordance with the terms of this Agreement, Buyer will have title to such stock free of any liens, encumbrances, claims or other limitations thereon as if Buyer is a bona fide purchaser as defined in the Uniform Commercial Code.

(8) As to such other matters as counsel for Buyer may reasonably request.

(d) The business and properties of the Company shall not have been materially adversely affected since the date hereof, whether by fire, casualty, act of God or otherwise, and there shall have been no other changes in the business, property, financial condition or future prospects of the Company that would have a material adverse effect on the value of its business or assets or upon its potential earning power.

(e) Sellers and the Company shall have certified that no adverse change has occurred which would materially affect the financial conditions of the business or its operations.

(f) The pre-acquisition audit of the business and records of the Company (to be made by Buyer prior to the Closing with the cooperation of Sellers and Company) in the reasonable opinion of Buyer will have revealed no facts materially and adversely affecting the business or its net worth. Buyer shall pay the expense of the independent Certified Public Accountant employed by Buyer to make such audit.

(g) Sellers and the Company shall have furnished to Buyer all supporting papers and documents reasonably requested to Buyer and shall have taken all action reasonably requested by Buyer in connection with the orderly transition of the business to Buyer.

6. (a) Sellers and the Company jointly and severally agree to indemnify, defend and hold Buyer harmless from all claims filed against the Company arising out of actions in respect of:

(1) All obligations and liabilities of the Company, whether accrued, absolute, fixed, contingent or otherwise, arising on or before the date of the Company balance sheet attached hereto as Exhibit "B", to the extent not reflected or reserved against thereon in the notes thereto.



(2) All liabilities of or claims against the Company arising out of the conduct of its respective businesses from and after the date of said balance sheet, to and including the Closing date, other than those incurred in the ordinary course of business or disclosed in or pursuant to this Agreement.

(3) Any loss, liability or damage suffered or incurred by Buyer or the Company because any representation or warranty contained herein, in any document furnished or required to be furnished pursuant to this Agreement by Sellers or the Company, or any document furnished to Buyer in connection with the Closing hereunder shall be false or misleading in any respect.

(4) All reasonable costs and expenses (including reasonable attorneys' fees) incurred by Buyer or the Company in connection with the defense of any action, suit, proceeding, demand, assessment or judgment incident to any of the matters indemnified against in this Paragraph 6(a).

(b) Buyer shall give Sellers notice as soon as reasonably practicable of any claim against Buyer or the Company which might give rise to a claim against Sellers based on the indemnity agreement contained in Paragraph 6(a), stating the nature and basis of said claims and the amount thereof. Sellers shall have a period of thirty (30) days within which, by written notice to Buyer, to assume the defense of any such claim. Notwithstanding the foregoing, Buyer may, pending Sellers' decision to defend, file notice of appearance or otherwise respond to any proceeding if the same shall be necessary in Buyer's judgment to preserve or protect the Company's and/or Buyer's position. If Sellers fail or refuse to accept such defense or to pay any such claim, Buyer may, in his sole and absolute discretion, defend against the same or settle or pay the same in such manner as he deems prudent. Buyer may withhold from the next payment or payments

due, or to become due, to Sellers under the terms of this Agreement, until the liability of Sellers for any such claim has been finally determined.

#### 7. *Miscellaneous.*

(a) In the event of a default by Buyer (while Sellers and/or the Company are not in default) which is not cured within thirty (30) days after written notice of said default, the balance of the down-payment of One Hundred Sixty-Five Thousand Dollars (\$165,000) as provided herein (plus the income thereon), plus any loans of Buyer to the Company from said \$165,000, shall be paid to Sellers as liquidated damages and all rights and obligations of the parties under this Agreement shall terminate.

(b) In the event of a default by Sellers or the Company (while Buyer is not in default) which is not cured within thirty (30) days after written notice of said default, Buyer may at his or its option waive said default and require performance by Sellers of this Agreement, or may terminate this Agreement as hereinafter provided. If said default results in whole or in part from or in a reduction in the net worth of the Company (other than in the usual course of business) compared to the balance sheet attached hereto as Exhibit "B", the purchase price shall be reduced accordingly, or Buyer may elect to terminate the transaction and in such event the Escrow Agent shall return the balance of said deposit of One Hundred Sixty-Five Thousand Dollars (\$165,000) (plus the income thereon) to Buyer, and the Company shall forthwith pay to Buyer the balance including accrued interest on any loan of Buyer to the Company, and all rights and obligations of the parties shall cease.

(c) Each party shall pay his or its costs of attorneys or accountants or similar fees and expenses. The Buyer shall bear the costs of the Escrow Agent.

(d) The warranties and representations of the parties shall survive the Closing. Except as to federal and state tax liabilities, said survival shall be limited to two (2) years from the date of Closing.

8. This Agreement binds and benefits the heirs, executors, administrators, successors and assigns of the parties hereto.

9. The parties agree that this Agreement may be properly executed by Ivan K. Landreth individually and as Agent for Ivan K. Landreth, Jr. and Thomas E. Landreth, said Ivan K. Landreth having represented that he is duly-authorized by said other Sellers to executed this Agreement and take any action necessary or appropriate to performing this Agreement.

EXECUTED under seal in duplicate this 6th day of October 1977.

/s/ Ivan K. Landreth  
IVAN K. LANDRETH

/s/ Thomas E. Landreth  
THOMAS E. LANDRETH

/s/ Ivan K. Landreth, Jr.  
IVAN K. LANDRETH, JR.  
"Sellers"  
LANDRETH TIMBER COMPANY, INC.

By /s/ Ivan K. Landreth  
Its President

/s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
"Buyer"

## LIST OF EXHIBITS

### *Exhibit*

- A Subordinated \$900,000 Note
  - B Balance Sheet
  - B-1 Material liabilities, obligations or commitments not appearing on financial statements
  - C Itemized scheduled of physical assets
  - D List of all material contracts for purchase of timber
  - E List of principal customers within the past three years
  - F Consulting Contract
  - G List of pending or threatened litigation, proceedings, claims or governmental investigations
- Bank's letter of commitment as provided in Paragraph 1(b)

The parties agree that the Exhibits shall be delivered to the parties prior to and such delivery shall be condition precedent to Closing and that, when so delivered shall be attached to and incorporated into this Agreement as of the execution hereof.

/s/ Ivan K. Landreth

# ASSIGNMENT AND ACCEPTANCE OF ASSIGNMENT AND ASSUMPTION

Pursuant to Section 3(b) of a Stock Purchase Agreement dated October 6, 1977 by and among Ivan K. Landreth, Thomas E. Landreth, Ivan K. Landreth, Jr., Landreth Timber Company, Inc. and Samuel S. Dennis 3d, said Samuel S. Dennis 3d hereby certifies that he has taken all steps contemplated in and required by said Section 3(b) to organize the corporation referred to in said Section 3(b) for whose use, benefit and advantage and on whose behalf said Samuel S. Dennis 3d entered into the said Stock Purchase Agreement solely as an accommodation party. Therefore, as contemplated and required by said Section 3(b), Samuel S. Dennis 3d hereby assigns to B & D Company, Inc., a Delaware corporation, all of his rights and obligations in, to and under the said Stock Purchase Agreement, with the effect set forth in said Section 3(b).

Executed as a sealed instrument as of this 7th day of November, 1977.

/s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D

The undersigned B & D Company, Inc. hereby represents and warrants to the several parties to the Stock Purchase Agreement that, as contemplated by said Section 3(b), it is validly organized and existing and has all the power and authority necessary to carry out and perform the Stock Purchase Agreement.

The undersigned hereby accepts the assignment by Samuel S. Dennis 3d set forth above of all his rights and obligations in, to and under the Stock Purchase Agreement. The undersigned expressly assumes all such obligations of Samuel S. Dennis 3d and by this instrument agrees to be substituted as the Buyer (as that term is

defined in the Stock Purchase Agreement) with the same legal effect as though the undersigned and not Samuel S. Dennis 3d had been the original party to the Stock Purchase Agreement.

Executed as a sealed instrument as of this 1st day of November, 1977.

B & D COMPANY, INC.

By /s/ John Bolten, Sr.  
JOHN BOLTEN, SR.  
Chairman of the Board



## PROMISSORY NOTE

The undersigned, Landreth Timber Company, Inc. ("Maker"), hereby promises to pay on demand to Samuel S. Dennis, 3d ("Lender"), or order, the amount of One Hundred Fifty Thousand Dollars (\$150,000), said amount to be paid by Maker on demand. Said amount shall bear no interest, provided that, if it is not paid within five (5) days after demand, interest shall accrue on the unpaid balance thereof at the rate of one percent (1%) per month until said amount is paid in full.

Maker hereby waives presentment, demand, notice of protest.

EXECUTED under seal November 16, 1977.

LANDRETH TIMBER COMPANY, INC.

By /s/ Ivan K. Landreth  
IVAN K. LANDRETH  
President  
Authorized Officer

## EXHIBIT B

LANDRETH TIMBER COMPANY, INC.

*Financial Statements*

(unaudited)

September 30, 1977

## HOMCHICK KOCH &amp; ASSOCIATES

## CERTIFIED PUBLIC ACCOUNTANTS

517 North Mission Street • Post Office Box 1371  
Wenatchee, Washington 98801 • Telephone 509/663-1131

October 26, 1977

Landreth Timber Company, Inc.  
Tonasket, Washington

The accompanying balance sheet of Landreth Timber Company, Inc. as of September 10, 1977, the related statements of income and changes in financial position and allied schedules for the nine months then ended were not audited by us and accordingly we do not express an opinion on them.

/s/ Homchick Koch & Associates

## Exhibit A

## LANDRETH TIMBER COMPANY, INC.

## Balance Sheet

(unaudited)

September 30, 1977

ASSETSCURRENT ASSETS

Cash in checking account		26 722
Cash in savings account		105 765
Accounts receivable (net of \$1,000 allowance for doubtful accounts)		3 217
Provision for Federal income tax refund		53 636
Inventories -		
Planed lumber (197 M ft.)	39 566	
Rough lumber (24 M ft.)	5 774	
Logs (1,045 M ft.)	184 913	230 253
Timber stumpage deposits		16 371
Total current assets		436 965

PROPERTY, MILL AND EQUIPMENT

Equipment	916 382	
Buildings	92 970	
	1 007 352	
Less: Accumulated depreciation	592 403	
	414 949	
Land	5 000	419 949

OTHER ASSETS

Goodwill		1 002
----------	--	-------

## TOTAL ASSETS

857 916

The accompanying notes are an integral part of these financial statements.

(unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITYCURRENT LIABILITIES

Accounts payable		19 261
Note payable to bank, second mortgage on mill		100 000
Note payable to bank		50 000
Note payable to Ivan K. Landreth, 8%		20 000
Accrued expenses -		
Wages	12 300	
Taxes and withholding	25 114	37 414
Current portion of long-term loan		50 000
Total current liabilities		276 675

UNEXPENDED FIRE INSURANCE PROCEEDS (Note 3)

76 025

LONG-TERM LOAN

Plant and equipment collateral loan, 90% guaranteed by SBA due in \$5,400 monthly installments including 9-1/2% interest	249 985	
Less: Current portion shown above	(50 000)	199 985

STOCKHOLDERS' EQUITY

Common stock - per value \$100 - authorized 1,000 shares - issued and outstanding 500 shares	50 000	
Retained earnings -		
Balance - January 1, 1977	392 795	
Less: Net loss for the nine months ended September 30, 1977	(149 411)	
Add: Actual Federal income tax refund claim in excess of amount accrued at December 31, 1976	11 847	
Balance - September 30, 1977	255 231	305 231

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY657 916

## Exhibit B

LANDRETH TIMBER COMPANY, INC.Statement of Income

(unaudited)

For the Nine Months Ended September 30, 1977

	<u>M Feet</u>	<u>Rate Per M</u>	<u>Total</u>
<u>INCOME</u>			
Lumber sold			
Planed fir	2 679	220.97	591 931
Rough fir	176	304.33	53 562
	<u>2 855</u>	<u>226.11</u>	<u>645 543</u>
Cost of lumber sold -			
Planed fir		277.05	742 226
Rough fir		240.60	42 346
		<u>274.81</u>	<u>784 572</u>
		<u>(48.70)</u>	<u>(139 029)</u>
	<u>Sales</u>	<u>Costs</u>	
Sale of wood chips	38 493	39 027	(.19)
Miscellaneous income			3.95
			<u>3.76</u>
			<u>(44.94)</u>
			<u>(128 298)</u>
<u>EXPENSES</u>			
Administrative		19.83	56 772
Discounts allowed		4.31	12 322
Shipping		1.93	5 555
		<u>26.18</u>	<u>74 749</u>
<u>NET LOSS BEFORE PROVISION FOR FEDERAL INCOME TAX REFUND</u>		<u>(71.12)</u>	<u>(203 047)</u>
<u>PROVISION FOR FEDERAL INCOME TAX REFUND</u>			<u>53 636</u>
<u>NET LOSS</u>			<u>(149 411)</u>
<u>NET LOSS PER SHARE</u>			<u>(298.82)</u>

The accompanying notes are an integral  
part of these financial statements.



## Exhibit C

LANDRETH TIMBER COMPANY, INC.  
Statement of Changes in Financial Position  
(unaudited)  
For the Nine Months Ended September 30, 1977

SOURCE OF FUNDS

Actual Federal income tax refund claim in excess of amount accrued at December 31, 1976	11 847
Credit received on equipment purchased in 1976	<u>1 194</u>
	<u>13 041</u>

APPLICATION OF FUNDS

Net loss	149 411
Less: Depreciation not requiring an outlay of working capital	<u>(50 580)</u>
Working capital used in operations	98 831
Payments on principal of long-term plant and equipment loan	<u>6 225</u>
	<u>105 056</u>

DECREASE IN WORKING CAPITAL

(92 015)

WORKING CAPITAL AT JANUARY 1, 1977

176 280

WORKING CAPITAL AT SEPTEMBER 30, 197784 265Summary of Changes in Working CapitalINCREASE (DECREASE) IN CURRENT ASSETS

Cash in bank	117 845
Accounts receivable	2 871
Inventories	57 248
Timber stumpage deposits	(7 209)
Provision for Federal income tax refund	<u>(80 364)</u>
	<u>90 391</u>

INCREASE (DECREASE) IN CURRENT LIABILITIES AND UNEXPENDED FIRE INSURANCE PROCEEDS

Accounts payable	6 939
Accrued expenses	24 517
Notes payable to bank	100 000
Balance due Internal Revenue Service per audit	(25 075)
Unexpended fire insurance proceeds	<u>76 025</u>
	<u>182 406</u>

DECREASE IN WORKING CAPITAL(92 015)

The accompanying notes are an integral part of these financial statements.

## Exhibit D

## LANDRETH TIMBER COMPANY, INC.

*Notes to Financial Statements*  
(unaudited)

September 30, 1977

**NOTE 1—SIGNIFICANT ACCOUNTING POLICIES**

The accrual method of accounting is used for all significant assets and liabilities.

Current assets and current liabilities include items expected to be, or which may be, realized or liquidated during the next twelve months.

Inventories are valued at the lower of average cost of market on a first-in, first-out basis.

Fixed assets are stated at cost. Maintenance and repairs, including the replacement of minor items, are charged to income and major additions are capitalized. Depreciation is computed primarily by the straight line method for items acquired prior to 1972 and declining balance method for items acquired after 1971.

Supplies are not a significant asset item and are expensed as purchased.

Other assets are valued at cost.

The corporation has approximately 2,000,000 ft. of logs "decked" in the woods in which it has incurred approximately \$100,000 of logging expenses. These logs have not been released by the forest service and the "stumpage" has not yet been incurred. The logging costs and some additional road costs have been expensed in the income statement and no asset is shown in the balance sheet.

*NOTE 2—MILL SHUTDOWN AND FIRE*

The mill was shut down in April, 1976 and was not reopened until March 1, 1977. A fire on May 10, 1977 destroyed substantially all of the sawmill portion of the mill. The mill was shut down again except the cut lumber on hand was processed through the dry kiln and planer which was not hurt in the fire. The operations for the nine months ended September 30, 1977 (especially the cost per M figures) do not reflect normal operating conditions.

The sawmill is in the process of being rebuilt and management estimates that the Helle portion of the sawmill construction will be completed by October 31 and in operation in November. The Maxi portion of the sawmill construction is expected to be completed in early December and in operation by the end of December.

*NOTE 3—UNEXPENDED FIRE INSURANCE PROCEEDS*

The corporation received \$700,000 fire insurance proceeds in June, 1977. Management estimates that it will cost between \$850,000 to \$900,000 to rebuild the sawmill. The proceeds not expended at September 30, 1977 are in a savings account and will be withdrawn and used as the mill is rebuilt.

*EXHIBIT B-1*

**MATERIAL LIABILITIES, OBLIGATION OR  
COMMITMENTS NOT APPEARING ON THE  
FINANCIAL STATEMENTS**

1. The Washington State Use Tax has not yet been determined or paid on certain equipment purchased outside the State of Washington and which has been or will be installed as a part of the new saw mill construction. At such time as the installation is completed this tax will become be determined and will become due.

2. Machinery and equipment contracts in connection with the new saw mill installation and will continue to come due as the balance of the machinery and equipment is delivered and installed. For deliveries and installation to date these contracts are on a substantially current basis.

## EXHIBIT C

## APPENDIXES

## SUMMARY OF PLANT &amp; PLANT EQUIPMENT

## SUMMARY OF NEW CONSTRUCTION

Concrete work 300 C.Y. @ 90.....	\$27,000	
Metal building (erected).....	75,000	
Walkways, stairs, handrails .....	15,000	
Lighting.....	10,800	
TOTAL CONTRACTORS COST.....	\$127,800	
CONSTRUCTION O.H., INT., PROFIT, 15%.....	19,200	
COMPLETED VALUE, NEW MILL BLDG.....		\$147,000
Sawmill equipment (installed) - Schedule "A".....	\$955,700	
Structural steel substructure 140,000# @ 0.70.....	98,000	
Hopperwork 20,000# @ 0.80.....	16,000	
Air and water piping.....	15,000	
Power and control wiring.....	270,000	
TOTAL EQUIPMENT COST.....	\$1,354,700	
CONSTRUCTION, O.H., INT., PROFIT 15%.....	203,000	
COMPLETED VALUE, NEW MILL EQUIPMENT.....		\$1,557,700
TOTAL VALUE OF NEW CONSTRUCTION WHEN COMPLETED.....		\$1,704,700

## SUMMARY OF EXISTING FACILITIES

Dry sorting shed.....	\$18,000	
Planer building .....	NIL	
Shop building - 1740 S.F.....	5,000	
Main office - 860 S.F.....	16,000	
Yard office & storage - 510 S.F.....	3,000	
Yard toilet & washroom - 220 S.F.....	4,000	
PRESENT VALUE, EXISTING BUILDINGS.....		\$46,000
Planing mill equipment (installed) - Schedule "B".....	\$92,800	
Existing log handling & edge sorter - Schedule "C".....	92,300	
Kilns & Kiln equipment - Schedule "D".....	240,300	
Chip & fuel system - Schedule "E".....	71,400	
Shop & misc. surplus equipment - Schedule "F".....	33,200	
Office equipment - Schedule "G".....	4,600	
Power & control wiring.....	32,000	
PRESENT VALUE, EXISTING EQUIPMENT.....		\$566,600
TOTAL PRESENT VALUE, EXISTING PLANT & BUILDINGS.....		\$612,600
TOTAL VALUE ALL PLANT & EQUIPMENT.....		\$2,317,300

PEASE &amp; BEADLING ENGINEERS INC

CLIENT RAINIER NATIONAL BANK

JOB NO. 11

PROJECT LANDRETH TIMBER CO. APPRAISAL

-2-



ITEM NO.	DESCRIPTION (motors & drives inc. unless noted)	EQUIPMENT W/TAXES	INSTAL- LATION	FREIGHT & HANDLING	TOTAL
1.	Maxi-Mill w/infeed & outfeed, rail beams	\$446,600	\$42,000	INC.	\$488,600
2.	Maxi-Mill saws, knives collars mis. equipment	11,900	INC.	300	12,200
3.	Helle Package Mill w/saws & laser lights	77,700	8,000	3,900	89,600
4.	Beloit head rig slabber w/setworks	22,000	2,000	700	24,700
5.	Filer & Stovell Edger w/infeed, outfeed, saws & lights	46,300	4,000	1,400	51,900
6.	Edger MG set	3,300	300	100	3,900
7.	Rotech resaw w/infeed, outfeed & saws	26,000	1,300	700	28,200
8.	Resaw MG set	3,000	300	100	3,400
9.	Schurman trimmer w/unscrambler, feeder saws	21,000	2,000	800	23,800
10.	Quincy air compressor w/dryer	6,300	500	200	7,000
11.	Gardiner-Denver air compressor w/dryer	7,900	1,300	300	9,900
12.	Soderhamn 48" chipper	9,000	700	300	10,000
13.	Chipper infeed conveyor, West Salem vibrating conveyor	8,400	900	300	9,600
14.	Grinding & filing equipment	11,300	1,000	400	12,900
15.	Lumber transfers & rollicases	78,000	16,000	2,000	96,000
16.	Waste conveyors	46,000	8,000	1,300	55,300
17.	Small log deck to Maxi-Mill	21,000	7,000	700	28,700
	TOTAL				\$933,700

PEASE & BEADLING ENGINEERS INC. CLIENT RAINIER NATIONAL BANK JOB NO. 113  
PROJECT LANDRETH TIMBER CO. APPRAISAL -13-

ITEM NO.	DESCRIPTION (motors & drives inc. unless noted)	EQUIPMENT W/TAXES	INSTAL- LATION	FREIGHT & HANDLING	TOTAL
1.	Planer, w/infeed table & outfeed rolls	\$11,000	\$1,300	\$300	\$13,000
2.	Trimmer w/saws & controls	22,000	3,000	1,000	26,000
3.	Splitter	6,000	300	200	6,700
4.	Air compressor	4,800	600	300	5,700
5.	Hog	2,800	400	200	3,400
6.	Moisture detector	3,000	600	100	3,700
7.	Knife grinding equipment	4,500	300	200	5,000
8.	Cut off saw	200	100	---	300
9.	Transfers & conveyors, installed				16,000
10.	Low pressure pneumatic conveying system, installed				9,000
11.	General construction				4,000
	TOTAL				\$92,800

PEASE & BEADLING ENGINEERS INC. CLIENT RAINIER NATIONAL BANK JOB NO. 113  
PROJECT LANDRETH TIMBER CO. APPRAISAL -13-

ITEM NO.	DESCRIPTION (motors & drives inc. unless noted)	EQUIPMENT W/TAXES	INSTAL- LATION	FREIGHT & HANDLING	TOTAL
1.	Nicholson debarker w/controls	\$19,000	\$3,000	\$300	\$22,300
2.	Debarker MC set	3,700	500	200	4,400
3.	Hydraulic power unit	2,000	300	100	2,400
4.	Deck saw w/log lift	2,100	400	100	2,600
5.	60" swing saw	2,600	800	200	3,600
6.	Infeed log deck	7,600	1,400	300	9,300
7.	Debarker infeed	3,000	600	200	3,800
8.	Debarker outfeed	9,300	1,800	400	11,700
9.	Bark conveyor	5,100	1,300	400	7,000
10.	Existing Substructure (present value)				3,000
11.	Edge sorter & green chain (present value)				22,000
	TOTAL				\$92,300

PEASE & BEADLING ENGINEERS INC. CLIENT RAINIER NATIONAL BANK JOB NO. 11  
PROJECT LANDRETH TIMBER CO. APPRAISAL -10

ITEM NO.	DESCRIPTION (motors & drives inc. unless noted)	EQUIPMENT W/TAXES	INSTAL- LATION	FREIGHT & HANDLING	TOTAL
1.	Kiln equipment, doors, roof, fans, baffles, controls, & rail	\$76,000	\$19,200	\$2,300	\$97,500
2.	Kiln general construction (masonry & concrete)				46,000
3.	Furnace & firing equipment (present value)				75,000
4.	Standby oil burner				10,000
5.	Oil & diesel tanks (installed)				2,000
6.	67-30" Kiln trucks @ \$30 ea.				2,000
7.	124-48" Kiln trucks @ \$33 ea.				4,300
8.	11-Single-bunk Kiln carts @ \$70 ea.				800
9.	26-Double-bunk Kiln carts @ \$90 ea.				2,300
10.	143-6"x3"x9" timber bunks @ \$4 ea.				600
	TOTAL				\$240,500

PEASE & BEADLING ENGINEERS INC. CLIENT RAINIER NATIONAL BANK JOB NO. 11  
PROJECT LANDRETH TIMBER CO. APPRAISAL -11

EDITOR'S NOTE

PAGES 240 thru 247 WERE POOR  
HARD COPY AT THE TIME OF FILMING.  
IF AND WHEN A BETTER COPY CAN BE  
OBTAINED, A NEW FICHE WILL BE  
ISSUED.





1.	30"x36" steel safe.....	\$500
2.	2- 5' desks @ \$150.....	300
3.	1- 5' desks w/typing stand attached.....	140
4.	3 swivel chairs @ \$50.....	150
5.	14 chairs @ \$25.....	350
6.	5- 4-drawer steel file cabinets @ \$120.....	600
7.	2 electric Olivetti typewriters @ \$250.....	500
8.	2 electric printing calculators @ \$120.....	240
9.	1 Sunbeam copy machine.....	320
10.	1- 42" round conference table.....	150
11.	2 fire extinguishers @ \$10.....	20
12.	1- 7'x3 1/2' supply cabinet.....	80
13.	1- 6' compartment foot locker.....	140
14.	19 cardboard file drawer @ \$5.....	95
15.	2- 6'x5' bookcase @ \$60.....	120
16.	1 paymaster check protector.....	100
17.	1 copy machine stand 26"x26".....	40
18.	1 typewriter stand.....	50
19.	2 decimal C scale sticks @ \$50.....	100
20.	1 vacume cleaner.....	30
21.	3 coat & hat racks @ \$20.....	60
22.	1- 2 hole paper punch.....	5
23.	1 radio.....	10
24.	2 double desk trays @ \$10.....	20
25.	4 round waste baskets @ \$5.....	20
26.	1 postal scale.....	15
27.	1 vertical file.....	10
28.	Misc. Accessories.....	20
29.	Misc. safety equipment (hard hats, gloves, lumber aprons, raincoats, ear protectors, first aid).....	300
TOTAL.....		\$4,600

PEASE &amp; BEADLING ENGINEERS, INC.

CLIENT RAINIER NATIONAL BANK

JOB NO. 113

PROJECT LANDRETH TIMBER CO. APPRAISAL

-12-

DESCRIPTION	SERIAL NUMBER	PRESENT VALUE
1964 Caterpillar D5H crawler tractor w/dozer blade, ripper & cab	46A-4660	\$29,500
1963 Caterpillar D6C crawler tractor w/dozer blade, winch & cab	76A-218	13,000
1967 Caterpillar 12-F motor patrol w/ripper	73G-2622	32,500
1952 Callion 11S motor patrol	18-546	3,500
1964 Caterpillar 955 wheel loader	98B-518	37,500
1961 Caterpillar 966A wheel loader	33A-668	10,500
1962 Caterpillar 966A wheel loader	33A-1009	12,500
1964 Hyster H130 fork lift (gas)	B7P1302H	9,500
1965 Hyster H130 E fork lift (diesel)	B7P19935	14,000
1964 Toumotor A-16 fork lift (diesel)	A166 0038	12,000
1965 Toumotor B-16 fork lift (diesel)	none	14,000
1948 Corlinger lumber carrier	1487	500
Ross 6636 lumber carrier	1968	500
Ross 80.7236 lumber carrier	85018	500
<u>ACCESSORY EQUIPMENT</u>		
2-Cravel buckets for 966A loaders @ \$2,500 ea.		5,000
Brush blade for D6C tractor		4,000
Chip loader blade for fork lift		3,000
TOTAL		\$205,000

PEASE &amp; BEADLING ENGINEERS, INC.

CLIENT RAINIER NATIONAL BANK

JOB NO. 113

PROJECT LANDRETH TIMBER CO. APPRAISAL

-13-

## SCHEDULE "I" — Highway Equipment

DESCRIPTION	SERIAL NUMBER	PRESENT VALUE
1952 Ford 1/2 ton pickup	F1D2RM10147	\$300
1963 Chevrolet 1/2 ton pickup	C13452144984	800
1956 International 1/2 ton 4x4 pickup	4X414749	1,000
1968 Chevrolet 1/2 ton 4x4 pickup	K51482139494	1,500
1972 Chevrolet 1/2 ton 4x4 pickup	1422153870	2,500
1975 Ford 3/4 ton F-250 4x4 pickup	F25YRV63679	4,200
1951 GMC Dump Truck	B270781127	1,300
1963 Ford T-750 Dump Truck	T75MV362330	3,200
1963 GMC Tandem Dump Truck Model WVS011	J2031K	4,300
1972 Volvo sedan	1646364057937	3,000
<u>ACCESSORY EQUIPMENT</u>		
1975 Pickup canopy 45 inches high		300
2-Fireboxes w/tools for pickups @ \$300 ea.		600
2- Fuel tanks w/hand pumps (in pickups) @ \$600 ea.		1,200
1200 Gallon water tank		800
1964 Trailer-mounted pumper w/300 gallon tank	78668	2,500
1967 Pacific trailer-mounted pumper w/300 gallon tank	1290	2,500
TOTAL		\$31,000

PEASE &amp; BEADING ENGINEERS, INC.

CLIENT RAINIER NATIONAL BANK  
PROJECT LANDRETH TIMBER CO. APPRAISALJOB NO. 113  
-20-

1- 7.50-16 unmounted recap 100% tread.....360  
 1- 9.00-20 unmounted recap 30% tread..... 75  
 1- 9.00-20 unmounted recap 20% tread..... 75  
 1- 9.00-20 mounted recap 10% tread.....115  
 1- 9.00-20 mounted recap 60% tread.....140  
 1- 9.00-20 mounted recap 40% tread.....120  
 1-10.00-20 mounted recap 60% tread.....140  
 1-10.00-20 mounted recap 80% tread.....180  
 1- 9.00-20 mounted recap 90% tread.....190  
 1-10.00-20 unmounted recap 100% tread.....160  
 1-10.00-20 unmounted recap 25% tread..... 75  
 1-10.00-20 unmounted recap 75% tread.....130  
 1-10.00-20 unmounted recap 80% tread.....145  
 1- 9.00-20 unmounted recap 80% tread.....135  
 1- 8.00-14 unmounted new 100% tread..... 70  
 1- 7.00-13 unmounted new 70% tread..... 40  
 1-10.00-13 mounted new 95% tread.....100  
 1- 9.00-20 unmounted recap 70% tread.....120  
 1- 9.00-20 unmounted recap 70% tread.....120  
 1-29.50-29 unmounted recap 60% tread.....320  
 1-18.00-23 mounted recap 30% tread.....200  
 1-14.00-24 mounted new 25% tread.....170  
 1-14.00-24 unmounted new 50% tread.....160  
 TOTAL TIRES.....\$3,040

PEASE &amp; BEADING ENGINEERS, INC.

CLIENT RAINIER NATIONAL BANK  
PROJECT LANDRETH TIMBER CO. APPRAISALJOB NO. 113  
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SCHEDULE "K" — Lumber &amp; Log Inventory

ITEM	QUANTITY FBN	PRICE (\$/MBF)	VALUE
1x4 Select	5,407	300	\$1,622
1x4 Lamstock	8,788	160	1,406
1x4 Utility	21,243	100	2,123
1x6 Select	2,771	350	970
1x6 Utility	8,869	100	887
1x8 Select	614	350	213
1x8 Lamstock	3,887	200	777
1x8 Std. & Constr.	1,700	130	223
1x8 Utility	600	100	60
1x6 Whitewood	700	120	84
1x8 Whitewood	100	130	13
2x2 Select	1,898	300	569
2x2 Std. & Constr.	7,312	170	1,243
2x2 Utility	5,463	170	928
2x3 Select	1,320	300	396
2x3 Std. & Constr.	9,195	170	1,563
2x3 Utility	6,965	170	1,184
2x3 Economy	2,340	50	117
2x4 Select	7,236	300	2,171
2x4 Lamstock	31,500	280	14,420
2x4 Economy	14,717	50	736
2x4 Whitewood	2,600	220	572
2x6 Select	1,328	300	398
2x6 # 1 & 2	8,352	250	2,088
2x6 # 4	3,750	50	188
2x6 Whitewood	1,500	240	360
2x8 Select	3,889	300	1,167
2x8 # 4	13,776	50	689
2x8 Whitewood	300	200	60
2x10 Select	1,000	300	300
2x10 # 4	2,800	50	140
2x12 # 4	800	50	40
TOTAL LUMBER	203,143		\$37,822
Fir & Larch logs	631,000	180	113,580
Spruce logs	148,000	180	26,640
Pine logs	246,000	200	49,200
TOTAL LOGS	1,025,000		\$189,420

PEASE & BEADLING ENGINEERS, INC.  
TIMBER APPRAISALCLIENT RAINIER NATIONAL BANK  
PROJECT LANDRETH TIMBER CO. APPRAISALJOB NO. 113  
-22-

SCHEDULE "L" — Analysis of Timber Contracts

U.S.F.S. SALE UNIT	CRAND	FROST	CUMBER	M.O.A.	ZIPPER	PETE'S LOOP	TOTAL
Original sale vol. (MBF)	10,700	10,100	3,700	3,700	5,400	6,100	39,400 MBF
Remaining volume	10,300	8,300	3,700	1,400	500	4,500	29,700 MBF
STUMPAGE COSTS							
Ponderosa pine volume		1,000					
Price (\$/MBF)		109.50					
Pine cost		\$109,500					\$109,500
Fir & Larch volume	10,300	6,500	3,700	1,400	500	4,500	
Price (\$/MBF)	115.69	86.94	99.73	48.67	85.20	83.44	
Fir & Larch cost	\$1,192,000	\$578,000	\$369,000	\$68,000	\$43,000	\$375,000	\$2,685,000
Slash disposal deposit	36.44	\$9.49	\$7.57	\$15.02	\$16.45	\$3.25	
Slash disposal cost	\$66,000	\$39,000	\$28,000	\$21,000	\$8,000	\$15,000	\$217,000
DEDUCT							
Unused road credits	(-\$67,000)	(-\$26,000)	(-\$11,000)	(-\$22,000)	(-\$12,000)	(-\$39,000)	(-\$155,000)
Total stumpage costs	\$1,191,000	\$830,000	\$396,000	\$67,000	\$49,000	\$331,000	\$2,525,000
LOGGING COSTS							
Road construction	\$59,000	\$1,000	\$1,000	\$48,000	\$37,000	\$55,000	\$114,000
Logging (\$34/MBF)	\$350,000	\$202,000	\$176,000	\$48,000	\$37,000	\$153,000	\$976,000
Hauling rate (\$/MBF)	18.00	19.00	19.00	14.00	16.00	23.00	
Hauling cost	\$185,000	\$158,000	\$70,000	\$20,000	\$8,000	\$104,000	\$545,000
DEDUCT							
Logs in deck in woods	1,500	1,500	700				3,700
Cutting & yarding (\$27/MBF)	(-\$40,500)	(-\$40,500)	(-\$18,900)				(-\$140,000)
Total logging costs	\$594,000	\$400,000	\$178,000	\$68,000	\$25,000	\$332,000	\$1,537,000
Total combined cost	\$1,785,000	\$1,230,000	\$574,000	\$155,000	\$74,000	\$443,000	\$4,461,000

Market value of pine @ mill = 1,000 MBF @ \$100..... \$100,000  
 Market value of fir & larch @ mill = 26,000 MBF @ \$180... 4,680,000  
 Total market value of all logs in all sales..... \$4,780,000  
 Less total combined costs to purchase & harvest..... -4,461,000  
 Net value of timber contracts..... \$319,000

PEASE & BEADLING ENGINEERS, INC.  
TIMBER APPRAISALCLIENT RAINIER NATIONAL BANK  
PROJECT LANDRETH TIMBER CO. APPRAISALJOB NO. 113  
-23-

DESCRIPTION OF PROPERTY OF THE APPRAISAL  
BY DOYLE RUARK OF THE PROPERTY OF  
IVAN LANDRETH

LANDRETH TIMBER CO., INC.

*PARCEL NO. 1*—That part of the NE $\frac{1}{4}$  of the NE $\frac{1}{4}$  of Section 10, Township 37 North, range 27 E.W.M., described as follows: Beginning at a point on the East line of said subdivision, distant 1271.6 feet from the Northeast corner thereof and run, thence North 52° and West a distance of 420 feet; thence North 78° 43' West a distance of 359.2 feet; thence South 74° 41' West a distance of 180.0 feet; thence South 16° 25' East a distance of 50 feet; thence South 31° 41' West a distance of 89.4 feet; thence South 43° 24' West a distance of 85.3 feet; thence south 55° 51' West, a distance of 110.85 feet; thence south 52° 22' West a distance of 93.2 feet; thence south 43° 16' East a distance of 52.6 feet; thence South 32° 18' West a distance of 35 feet more or less, to the South line of Said NE $\frac{1}{4}$  of NE $\frac{1}{4}$ , thence Easterly along the south line of said subdivision to the Southeast corner thereof; thence Northerly along the East line of said subdivision to the point of beginning.

*PARCEL NO. 2*—That part of the Se $\frac{1}{4}$  of the NE $\frac{1}{4}$  of Section 16, Township 37 North, Rge., 27 E.W.M., lying East of the right of way of the Oroville-Tonasket Irrigation District Canal and North of Permanent Highway #28 (Tonasket-Havillan Road).

*PARCEL NO. 3*—That part of the S $\frac{1}{2}$  of the NW $\frac{1}{4}$  of Section 15, Township 37 N., Rge., 27 E.W.M., lying North of the County Road, F18 otherwise known as the Tonasket-Molson Road. Reserving from above described lands, a tract described as follows: Commencing at the Westerly most corner of Tract 32 Orchard View Addition to Tonasket, Washington, thence on and along the Southwesterly line of Tract 32, a distance of 102.9 feet to the point of

beginning being on the southeasterly right of way of the Oroville-Tonasket irrigation Ditch; Thence South 61° 57' East a distance of 200 feet; thence S. 64° 46' East a distance of 208 feet; thence N. 18° 26' East a distance of 762 feet; thence North 80° West a distance of 19.8 feet; thence N. 81° 35' West a distance of 60.0 feet; thence S. 37° 08' West a distance of 200 feet; thence S. 54° 61' West a distance of 200 feet; thence South 38° 03' West a distance of 200 feet; thence South 53° 10' West a distance of 183.7 feet to the point of commencement.

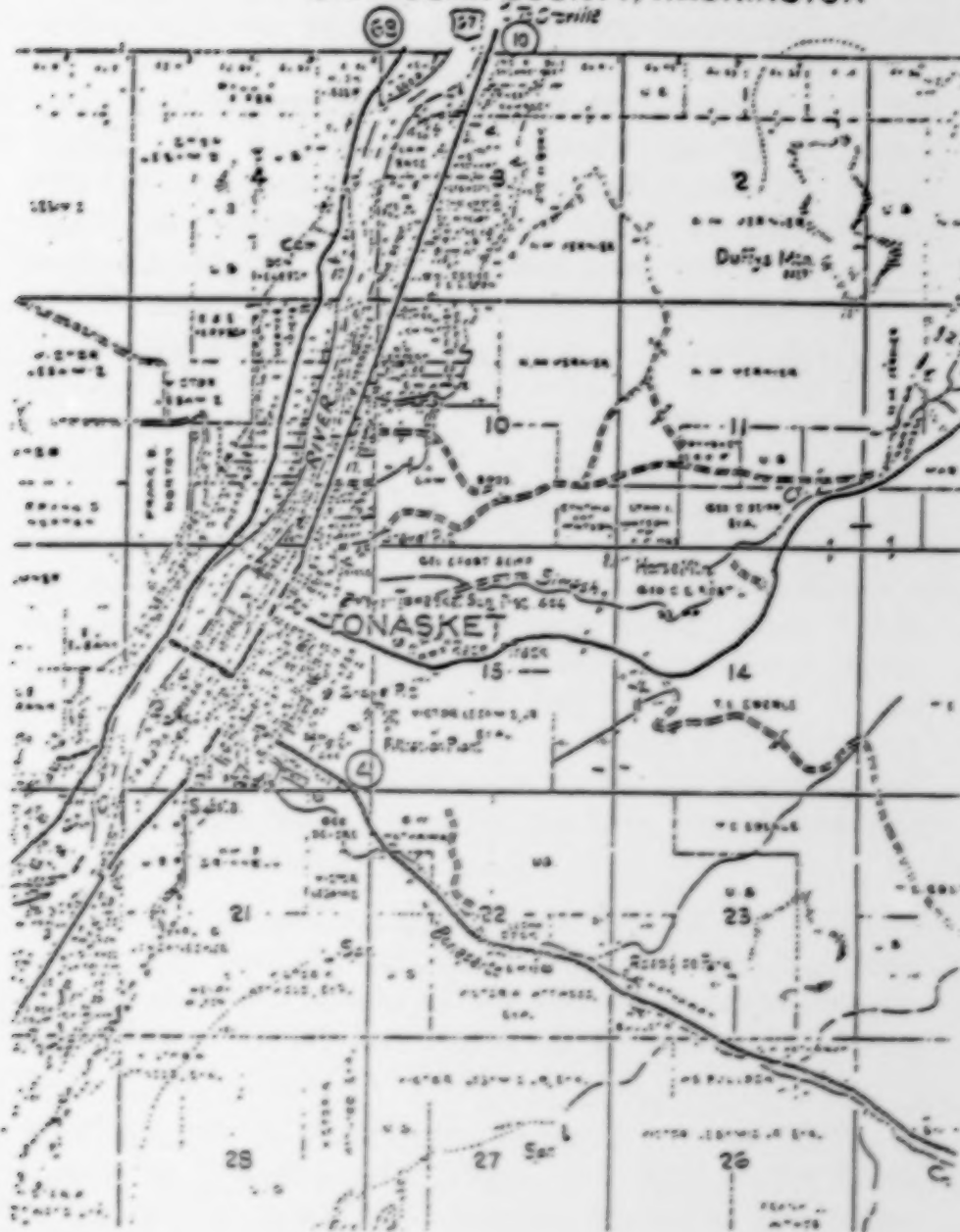
SITUATE IN OKANOGAN COUNTY, WASHINGTON.

S.G.C.

Established Acreage 73 acres approximately.

Doyle Ruark

## OKANOGAN COUNTY, WASHINGTON

*Lumber Customers*

- A & R Lumber Sales, P.O. Box 2803, Eugene, Oregon 97402
- Able Fab, Inc., P.O. Box 5274, Spokane, Wa. 99205
- American International Forest Products, Inc., P.O. Box 4166, Portland, Oregon 97208
- American River Lbr. Co. Inc., P.O. Box 16010, Portland, Oregon 97216
- Balfour Guthrie Canada Ltd., 740 Nicola St., Vancouver, B. C. V68202
- Barnett Lumber Industries, P.O. Box 34279, Postal Station "D", Vancouver, B. C. Canada VJ6 4P2
- Burns Kneeland Lumber, Aitkin, Minn. 56431
- Capital Building Systems, P.O. Box 830, Huron, South Dakota 57350
- Chandler Corp., P.O. Box 2840, Boise, Idaho 83701
- Chapman Lbr. Co., 813 S. W. Alder St., Portland, Oregon 97205
- Contact Lumber Company, 819 Corbett Building, Portland, Oregon 97204
- Dant & Russell, Inc., P.O. Box 587, North Plains, Oregon 97133
- Figenshow Lumber Company, Inc., Tonasket, Wa. 98855
- Forest Glen Lbr. Co., Box 310, Medford, Oregon 97501
- Gill Forest Products, P.O. Box 651, Bellevue, Mn. 98009
- Glacier Forest Products, P.O. Box 2413, Great Falls, Montana 59404
- Gold Rey Forest Products, Inc. P.O. Box 687, Beaverton, Oregon 97005
- Gray Co., Inc., 1512 St. Paul Ave., Tacoma, Wa. 98421



Hall Lumber Sales, Inc., P.O. Box 97, Middleton, Wisconsin 53562

Inland Lumber Co., P.O. Box 190, Colton, Calif. 92324

International Paper Co., Woodlands Accounts Dept., P.O. Box 579, Longview, Wa. 98632

Matheus Lumber Company, Inc., P.O. Box 019004, 2562 Dexter Avenue North Seattle, Wa. 98109

Midwest Export & Import Co., P.O. Box 6675, Detroit, Michigan 48240

NEPA Wholesale Lumber Sales, P.O. Box 601, Snohomish, Washington 98290

North Pacific Lumber Co., P.O. Box 3915, 1505 S. E. Gideon, Portland, Oregon 97208

Port Barre Lumber Ind. Inc., Port Barre, La., 70577

Newport Int. Forest, Inc., P.O. Box 705, Corona del Mar, Calif., 92625

Oregon Pacific Ind., S. W. Orepac Ave., Wilsonville, Oregon 97070

Potlatch Corp., P.O. Box 25445, Portland, Oregon 97225

Rogue Forest Prod., P.O. Box 1211, Medford, Oregon 97501

Rowles—Westrum Lbr. Co. L.T.D., #2041330—8th St. S. W., Calgary, Alberta, Canada

Sequoia Supply, P.O. Box 98480, Tacoma, Washington 98499

Taiga Wood Products Ltd., P.O. Box 80329, South Burnaby, B.C. Canada

Timberweld Mfg., P.O. Box 66B, Columbus, Montana 59019

Trumark Industries, Terminal Box 3045, Spokane, Wa. 99220

United-Alpine Lumber Co., 4800 S. W. Macadam Avenue —Rm. 305, Portland, Oregon 97201

West Coast Forest Industries, 10550 S.W. Allen Blvd., Beaverton Ore. 97005

Western Empire Forest Products, P.O. Box 5301, Eugene, Oregon 97405

Wood Market, Inc., 840 Crown Plaza Bldg., Portland, Oregon 97201

**EXHIBIT D****LIST OF ALL MATERIAL CONTRACTS  
FOR TIMBER**

U.S. Forest Service, USDA, as Seller, Timber Purchase Contract to Landreth Timber Company, Inc., as Purchaser.

Name of Sale	Expiration Date	App. Volume Balance
(a) Grand	1980	10.3 (Million BF)
(b) Frost	1980	8.3
(c) Pete's Loop	1980	4.5
(d) Cumber	1978	3.7
(e) NOA	1978	1.4
(f) Zipper	1978	.5
		28.7 Million BF

**EXHIBIT E***Lumber Customers*

A & R Lumber Sales, P.O. Box 2803, Eugene, Oregon 97402

Able Fab, Inc., P.O. Box 5274, Spokane, Wa. 99205

American International Forest Products, Inc., P.O. Box 4166, Portland, Oregon 97208

American River Lbr. Co. Inc., P.O. Box 16010, Portland, Oregon 97216

Balfour Guthrie Canada Ltd., 740 Nicola St., Vancouver, B. C. V60202

Barnett Lumber Industries, P.O. Box 34279, Postal Station "D", Vancouver, B. C. Canada VJ6 4P2

Burns Kneeland Lumber, Aitkin, Minn. 56431

Capital Building Systems, P.O. Box 830, Huron, South Dakota 57350

Chandler Corp., P.O. Box 2840, Boise, Idaho 83701

Chapman Lbr. Co., 813 S. W. Alder St., Portland, Oregon 97205

Contact Lumber Company, 819 Corbett Building, Portland, Oregon 97204

Dant & Russell, Inc., P.O. Box 587, North Plains, Oregon 97133

Figenshow Lumber Company, Inc., Tonasket, Wa. 98855

Forest Glen Lbr. Co., Box 310, Medford, Oregon 97501

Gill Forest Products, P.O. Box 651, Bellevue, Wn. 98009

Glacier Forest Products, P.O. Box 2413, Great Falls, Montana 59404

Gold Rey Forest Products, Inc. P.O. Box 687, Beaverton, Oregon 97005

Gray Co., Inc., 1512 St. Paul Ave., Tacoma, Wa. 98421  
 Hall Lumber Sales, Inc., P.O. Box 97, Middleton, Wisconsin 53562  
 Inland Lumber Co., P.O. Box 190, Colton, Calif. 92324  
 International Paper Co., Woodlands Accounts Dept., P.O. Box 579, Longview, Wa. 98632  
 Matheus Lumber Company, Inc., P.O. Box C19004, 2562 Dexter Avenue North, Seattle, Wa. 98109  
 Midwest Export & Import Co., P.O. Box 6675, Detroit, Michigan 48240  
 NEPA Wholesale Lumber Sales, P.O. Box 601, Snohomish, Washington 98290  
 North Pacific Lumber Co., P.O. Box 3915, 1505 S. E. Gideon, Portland, Oregon 97208  
 Port Barre Lumber Ind. Inc., Port Barre, La. 70577  
 Newport Int. Forest, Inc., P.O. Box 705, Corona del Mar, Calif. 92625  
 Oregon Pacific Ind., S. W. Orepac Ave., Wilsonville, Oregon 97070  
 Potlatch Corp., P.O. Box 25445, Portland, Oregon 97225  
 Rogue Forest Prod., P.O. Box 1211, Medford, Oregon 97501  
 Rowles—Westrum Lbr. Co. L.T.D., #2041330—8th St. S. W. Calgary, Alberta, Canada  
 Sequoia Supply, P.O. Box 98480, Tacoma, Washington 98499  
 Taiga Wood Products Ltd., P.O. Box 80329, South Burnaby, B.C. Canada  
 Timberweld Mfg., P.O. Box 66B, Columbus, Montana 59019

Trumark Industries, Terminal Box 3045, Spokane, Wa. 99220  
 United-Alpine Lumber Co., 4800 S. W. Macadam Avenue—Rm. 305, Portland, Oregon 97201  
 West Coast Forest Industries, 10550 S.W. Allen Blvd., Beaverton, Ore. 97005  
 Western Empire Forest Products, P.O. Box 5301, Eugene, Oregon 97405  
 Wood Market, Inc., 840 Crown Plaza Bldg., Portland, Oregon 97201



**EXHIBIT F****CONSULTING AND NONCOMPETITION  
AGREEMENT**

Effective as of November 17, 1977, B&D Company, Inc. (the "Company"), a Delaware corporation, and Ivan K. Landreth (the "Consultant") agree as follows:

1. *Consulting Arrangement.*

1.1. *Consulting Period.* The Company shall employ the Consultant as a consultant to the Company for a period of one (1) year commencing on the date of this Agreement (such period, as it may be extended, the "Consulting Period").

1.2. *Consulting Duties, etc.* The Company shall employ the Consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the Consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as a consultant to the Company in connection with such participation and for such purposes.

2. *Compensation.*

2.1. *Compensation During Consulting Period.* The Company shall pay the Consultant monthly at the rate of Two Thousand Five Hundred Dollars (\$2,500) per month for the first six (6) months of the Consulting Period and at the rate of One Thousand Dollars (\$1,000) per month for the second six (6) months of the Consulting Period.

2.2. *Reimbursement of Costs and Expenses.* Consultant will be reimbursed for his reasonable costs and ex-

penses in connection with the performance of services specifically requested by the Company upon reasonable substantiation and approval by the Company of such costs and expenses.

3. *Noncompetition.* At all times during the Consulting Period and for a period of three (3) years after termination of the Consulting Period, the Consultant shall not, directly or indirectly, as an employee of any person or entity (whether or not engaged in business for profit), individual proprietor, partner, stockholder, director, officer, joint venturer, investor, lender or in any other capacity whatever, compete with the business of the Company or any subsidiary of the Company (each such subsidiary, a "Company Subsidiary"). As used in this Agreement, "compete", "competition" or any variation thereof, means engagement or participation of the Consultant in, or his furnishing aid or assistance in connection with, the design, manufacture, distribution, sale, marketing or rendering of products or services of the type and kind designed, manufactured, distributed, sold, marketed or rendered by the Company or any Company Subsidiary in the Consulting Period or in the one-year period preceding the Consulting Period, including, but not limited to, those products or services the Company or any Company Subsidiary, as the case may be, was then in the process of developing or designing for manufacture, sale, marketing or rendering in the States of California, Idaho, Oregon, Washington and Wyoming.

4. *No Solicitation of Employees.* At all times during the Consulting Period and for a period of three (3) years after termination of the Consulting Period, the Consultant shall not, directly or indirectly, or by any act in concert with others, employ, attempt to employ, recruit or otherwise solicit or induce or influence to leave his employment any employee of the Company or any Company Subsidiary for any purpose. The restrictions

described in this Section 4 are applicable in the States of California, Idaho, Oregon, Washington and Wyoming.

5. *No Disclosure of Information.* The Consultant shall not at any time divulge, use, furnish, disclose or make accessible to anyone other than the Company or a Company Subsidiary or their respective directors or officers any knowledge or information with respect to (a) confidential or secret processes, plans, formulas, data (including cost data), machinery, drawings, specifications, manufacturing procedures and techniques, methods, technology, know-how, programs, devices or material relating to the business, products (whether existing or under development), services or activities of the Company or any Company Subsidiary; (b) any confidential or secret engineering, research, development or other original work of the Company or any Company Subsidiary; (c) any other confidential or secret aspects of the business, products or activities of the Company or any Company Subsidiary; or (d) any customer usages and requirements or any customer lists of the Company or any Company Subsidiary. All records, materials and information obtained by the Consultant in the course of his employment by the Company shall be deemed confidential and shall remain the exclusive property of the Company. This provision shall not apply to any information which at any time comes into the public domain other than as a result of the violation of the terms of this Section 5 by the Consultant.

6. *Enforceability.* The Company and the Consultant recognize that any breach by the Consultant of any of his obligations under Sections 3 and 4 would result in irreparable injury and damage to the overall reputation of the Company and to its business and affairs. The Company and the Consultant therefore consider the restrictions contained in Sections 3 and 4 to be reasonable as to the covenants of, and the duties and restrictions imposed on, the Consultant therein, whether in terms of

extent, time or geographic area. However, if any such covenants, duties or restrictions are found by any court having competent jurisdiction to be unreasonable because they are (or any one of them is) too broad, then those covenants, duties or restrictions shall nevertheless remain effective, but shall be considered amended as to extent, time or geographic area (or any one of them, as the case may be) in whatever manner is considered reasonable by such court, and as so amended shall be enforced.

7. *Relief in Case of Breach.* The services to be rendered by the Consultant to the Company in the Consulting Period are unique and extraordinary, which gives them a value peculiar to the Company; and the Company cannot be reasonably or adequately compensated in damages for their loss. Accordingly, any breach by the Consultant of the terms of this Agreement, including, but not limited to, the terms of Sections 3 and 4, will cause the Company irreparable injury and damage. Therefore, the Company shall be entitled, in addition to all other remedies available to it, to injunctive and other available equitable relief in any court of competent jurisdiction to prevent or otherwise restrain a breach of this Agreement, without notice of the Consultant, for the purpose of enforcing this Agreement or any of its terms.

8. *Termination of Employment.* All employment of the Consultant by the Company under this Agreement shall terminate on the earliest to occur of the following dates:

- a ( ) Upon expiration of the Consulting Period.
- (b) Upon the death or disability of the Consultant. For purposes of this Agreement, the Consultant shall be deemed disabled if he has been unable to render the services required to be rendered by him in the Consulting Period for thirty (30) consecutive days.



(c) At the election of the Company, upon thirty (30) days' prior written notice.

9. *Payments Upon Termination.* If all employment of the Consultant by the Company under this Agreement is terminated, the Company shall pay the Consultant the compensation otherwise payable to him under Section 2 through the date of such termination.

10. *Miscellaneous.* This Agreement shall inure to the benefit of and be binding upon the Company and the Consultant and their respective successors, executors, administrators, heirs and permitted assigns; *provided* that the Consultant may not make any assignment of this Agreement or any interest therein, by operation of law or otherwise, without the prior written consent of the Company. This Agreement constitutes the entire agreement between the parties and may not be changed except by a writing duly executed and delivered by the Company and the Consultant in the same manner as this Agreement. This Agreement is governed by and shall be construed in accordance with the laws of the State of Washington. The Company and the Consultant may execute this Agreement in any number of counterparts, each of which is an original, but all of which shall constitute but one instrument. In proving this Agreement, it shall not be necessary to produce or account for more than one such counterpart. This Agreement supersedes in all respects any prior agreement between the Company and the Consultant relating to any of the subject matter hereof.

B&D COMPANY, INC.

By \_\_\_\_\_  
SAMUEL S. DENNIS 3d  
Its President

\_\_\_\_\_  
IVAN K. LANDRETH

## EXHIBIT G

### LIST OF PENDING OR THREATENED LITIGATION PROCEEDINGS, CLAIMS OR GOVERNMENTAL INVESTIGATION

None to the best knowledge and belief of the Stockholders, Directors and Officers of Landreth Timber Company, Inc.



## ASSIGNMENT OF, AND AMENDMENT TO, STOCK PURCHASE AGREEMENT

Effective as of November 16, 1977, Ivan K. Landreth, Thomas E. Landreth and Ivan K. Landreth, Jr. (the "Sellers"), Landreth Timber Company, Inc. (the "Company"), Samuel S. Dennis, 3d ("Mr. Dennis"), and B&D Company, Inc. (the "Substituted Buyer") agree as follows:

1. *Background.* The Sellers, the Company and Mr. Dennis (acting solely as an accommodation party for the benefit and on behalf of the Substituted Buyer) are parties to a Stock Purchase Agreement dated October 6, 1977 (the "Stock Purchase Agreement"). The parties to this agreement wish to substitute the Substituted Buyer for Mr. Dennis as "the Buyer" under the Stock Purchase Agreement, to amend certain terms of the Stock Purchase Agreement as set forth below, and to conform all other terms of the Stock Purchase Agreement that are not so amended.

2. *Substitution of Substituted Buyer.* The Substituted Buyer is hereby substituted for Mr. Dennis as "the Buyer" referred to in the Stock Purchase Agreement with the same legal effect as though the Substituted Buyer had been the original party to the Stock Purchase Agreement in the place of Mr. Dennis. Mr. Dennis hereby assigns all of his rights and obligations in, to and under the Stock Purchase Agreement to the Substituted Buyer. The Substituted Buyer hereby accepts the assignment by Mr. Dennis to it of all his rights and obligations in, to and under the Stock Purchase Agreement, and acknowledges that it is fully bound by the terms of the Stock Purchase Agreement as the Buyer referred to in the Stock Purchase Agreement. The parties to this agreement all hereby acknowledge that Mr. Dennis executed the Stock Purchase Agreement as "the Buyer" referred to in the Stock Purchase Agreement

solely as an accommodation party for the benefit and on behalf of the Substituted Buyer, and that he is hereby discharged from any and all obligations under the Stock Purchase Agreement as completely as if he had never been a signatory to the Stock Purchase Agreement.

3. *Representation and Warranty of Mr. Dennis and Substituted Buyer.* Mr. Dennis and the Substituted Buyer hereby jointly and severally represent and warrant to the Sellers and the Company that the Substituted Buyer is validly organized and existing and has all the power and authority necessary and appropriate to carry out and perform its obligations as "the Buyer" under the Stock Purchase Agreement.

4. *Amendment to Paragraph 1.* Paragraph 1 of the Stock Purchase Agreement is hereby amended in its entirety to read as follows:

"1. The Sellers agree to sell and the Buyer agrees to buy said shares for a total price of Three Million Dollars (\$3,000,000) payable as follows:

(a) One Hundred Sixty-five Thousand Dollars (\$165,000) in cash upon the execution and delivery of fully-executed copies of the agreement to the respective parties. Said down payment shall be held in escrow by Rainier National Bank, Seattle, Washington (the "Bank") and, subject to the provisions of Paragraph 4 hereinafter, delivered to the Sellers at the Closing; provided, that upon the request of Ivan K. Landreth, the Bank shall advance to the Company such amounts from said escrow cash as Mr. Landreth requests for use in conducting the business until the Closing. Said amounts shall constitute a non-interest bearing, unsecured demand loan to the Company from the Buyer.

- (b) Seven Hundred Fifty Thousand Dollars (\$750,000) in cash, to be paid at Closing (of which amount Fifty Thousand Dollars (\$50,000) shall be payable to an escrow agent mutually acceptable to the Buyer and the Sellers) as provided in Paragraph 4. A note secured by a first mortgage on certain assets of the Company payable to the Small Business Administration amounting to Two Hundred Fifty-three Thousand Ninety-five Dollars (\$253,095) on August 31, 1977, and notes payable to banks secured by a second mortgage on certain property of the Company or by personal collateral of Ivan K. Landreth in the total principal amount of One Hundred Fifty Thousand Dollars (\$150,000) shall be caused to be paid by the Buyer at the Closing. An irrevocable written commitment of Rainier National Bank addressed to the Buyer to pay the cash balance due the Sellers on January 10, 1978. Said commitment shall be subject to the provisions of this Agreement and in a form satisfactory to counsel for said banks and counsel for the Sellers.
- (c) The Sellers shall at the Closing deliver the shares of the Company to be sold under this Agreement to the Buyer, properly endorsed for transfer with signatures guaranteed.
- (d) The balance of the total purchase price of Three Million Dollars (\$3,000,000) in the amount of Two Million Two Hundred Fifty Thousand Dollars (\$2,250,000) shall be paid in cash on January 10, 1978 without interest (of which amount One Hundred Thousand Dollars (\$100,000) shall be payable to an escrow agent mutually acceptable to the Buyer and the Sellers).

The Sellers agree that Fifty Thousand Dollars (\$50,000) of the Seven Hundred Fifty Thousand Dollars (\$750,000) to be paid at the Closing, and One Hundred Thousand Dollars (\$100,000) of the Two Million Two Hundred Fifty Thousand Dollars (\$2,250,000) to be paid on January 10, 1978, pursuant to subparagraphs (b) and (d) of this Paragraph 1, respectively, shall be paid over to an escrow agent mutually acceptable to the Buyer and the Sellers for a period of two (2) years as security for the accuracy of the representations and warranties, and the performance of the covenants, of the Sellers and the Company in this Agreement, all pursuant to an escrow agreement to be satisfactory in form and substance to the Sellers, the Company, the Buyer and such escrow agent."

5. *Amendment to Paragraph 2.* Paragraph 2 of the Stock Purchase Agreement is hereby amended to add after subparagraph (p) thereof the following additional subparagraphs (q), (r) and (s):

"(q) The contracts of the Company with the Small Business Administration are fully transferable and assignable to the Buyer.

"(r) The Company shall have actively and continuously engaged in the milling, manufacture and marketing of lumber and other forest products at all times during the five-year period immediately prior to the Closing Date.

"(s) The financial information relating to the Company set forth in *Exhibit H* attached to this Agreement is complete and correct as of the date of such *Exhibit H*."

6. *Amendment to Paragraph 4.* Paragraph 4 of the Stock Purchase Agreement is hereby amended to revise subparagraph (c) thereof to read as follows:



"(c) At the Closing, the Buyer shall or cause to be delivered to the Sellers the following:

- (1) Seven Hundred Thousand Dollars (\$750,000) cash (of which amount Fifty Thousand Dollars (\$50,000) shall be payable to an escrow agent mutually acceptable to the Buyer and the Sellers).
- (2) A letter of commitment from Rainier National Bank to Sellers as provided in Paragraph 1(b)."

7. *Amendment to Paragraph 7.* Paragraph 7 of the Stock Purchase Agreement is hereby amended to delete subparagraph (d) and to insert in its place a new subparagraph (d) as follows:

"(d) The warranties and representations of the parties shall survive the Closing. Except for all warranties and representations of the Company and the Sellers which relate to federal and state tax liabilities and stock issuance and ownership, said survival shall be limited to two (2) years from the date of Closing."

8. *Cooperation, etc.* The Sellers hereby covenant to the Substituted Buyer that they will cooperate with the Substituted Buyer on a basis mutually satisfactory to the Sellers and the Substituted Buyer in order to enable the Substituted Buyer (a) to obtain necessary financing in connection with the start-up operations of the Maximill being constructed by the Company, and (b) to build up the values of the inventory and accounts receivable of the Company.

9. *Confirmation of Terms.* The Company, the Sellers and the Substituted Buyer hereby confirm all of the terms of the Stock Purchase Agreement that are not amended by this agreement, all of which unamended terms shall be deemed incorporated by reference in this

agreement as fully as if they were set forth in their entirety herein.

EXECUTED under seal in duplicate this November 16, 1977.

Agreed to and Accepted:

/s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
B&D COMPANY, INC.

By /s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
President

LANDRETH TIMBER COMPANY, INC.

By /s/ Ivan K. Landreth  
IVAN K. LANDRETH  
President

/s/ IVAN K. LANDRETH  
IVAN K. LANDRETH

/s/ IVAN K. LANDRETH  
IVAN K. LANDRETH  
as Attorney-in-Fact  
for Thomas E. Landreth and  
Ivan K. Landreth, Jr.



EDITOR'S NOTE

PAGES 270 thru 274 WERE POOR  
HARD COPY AT THE TIME OF FILMING.  
IF AND WHEN A BETTER COPY CAN BE  
OBTAINED, A NEW FICHE WILL BE  
ISSUED.

## EXHIBIT H

LANDRETH TIMBER COMPANY, INC.  
A Washington State Corporation

## Balance Sheet

(Unaudited)

November 16, 1977

## ASSETS

## Current Assets

Cash in bank (per Mrs. Burse)	4,400
Accounts receivable (per Mr. Landreth)	2,500
Provision for Federal income tax refund (same as 9/30/77)	53,636
Inventories, per Mr. Landreth, at fair market value	201,533
Timber stumpage deposits	<u>16,371</u>
Total current assets	<u>278,440</u>

## Property, Mill and Equipment, at cost less accumulated depreciation

Equipment and Buildings at 9/30/77	1,007,352
Additions: Capital expenditure in Oct. 1977 (per Mr. Landreth's schedule)	60,642
Capital expenditure 11/1/77-11/16/77 (per Mr. Landreth's schedule)	82,793
Capital expenditure 11/17/77 thru mill completion (per Mr. Landreth's schedule)	<u>136,789*</u>
	280,224
Less: Unexpended fire proceeds 9/30/77	(76,025)
Reconciling item for small items	<u>(8,617)</u>
Mr. Landreth's project estimate, less \$700,000 insurance proceeds	<u>195,582</u>
	<u>1,302,934</u>
Less: Accumulated depreciation at 9/30/77	592,403
Approximate depreciation for Oct./Nov. 1977 (same as for July/Aug. 1977):	
Balance 8/31/77	536,783
Balance 6/30/77	<u>579,563</u>
	<u>11,240</u>
	(603,643)
	599,291
Land at cost	<u>5,000</u>
	<u>604,291</u>

## Other Assets

Goodwill	<u>1,000</u>
	<u>9,853,733</u>

## Exhibit H (Continued)

LANDRETH TIMBER COMPANY, INC.  
A Washington State Corporation

## Balance Sheet

(Unaudited)

November 16, 1977

## LIABILITIES AND STOCKHOLDERS' EQUITY

## Current Liabilities

Accounts payable, general (per Mr. Landreth)	3,300
Note payable to bank, second mortgage on mill	130,000
Note payable to Mr. S. S. Dennis Jr	150,000
Note payable to bank	30,000
Accrued expenses (per Mr. Landreth):	
- loan interest	3,269
- equipment and buildings (per attached schedule)	136,789*
- balance of wages payable 11/18/77	4,000
- tax and withholding	<u>7,000</u>
	131,058
Current portion of long-term loan	<u>30,000</u>
Total current liabilities	<u>504,358</u>

## Long-Term Loan

Plant and equipment collateral loan, 90% guaranteed by SBA due in \$5,400 monthly installments including 9-1/2% interest	247,969
Less: Current portion above	<u>30,000</u>
	197,969

## Stockholders' Equity

Common Stock - par value \$100 - authorized 1,000 shares	
- issued and outstanding 500 shares	<u>50,000</u>
Retained earnings balance 9/30/77	235,231
Balancing figure, representing approximate loss for 10/1/77 through 11/16/77	<u>(74,025)**</u>
	<u>160,179</u>
	<u>181,206</u>
	<u>\$ 853,733</u>

\* Includes \$14,000 capitalized wages payable on 11/18/77.

\*\* This \$74,025 represents losses in the ordinary course of business per Ivan Landreth

NOTE: It is recognized that the current liabilities less the current assets on this balance sheet, amounting to \$226,118 (\$504,358 less \$278,440), may vary by plus or minus \$3,000.

Attachment to Exhibit H

(November 16, 1977)

LANDRETH TIMBER COMPANY, INC.Capital Expenditure Amounts Paid October 1977  
(per Mr. Landreth)

18,127	Electrical Equipment
145	Miscellaneous
1,875	Saws Helle Blades
500	Freight
160	Supplies
60	Supplies
804	Supplies
718	Supplies
4,938	Stack Steel - Maxi Mill
942	Oxygen Rods
685	Electric Items
19,100	Washington Sales - Sawmill Equipment Resaw
5,797	Nicholson Manufacturing
<u>6,791</u>	Pacific Saw Knife - Grinding
<u>\$60,642</u>	

November 15, 1977

Attachment to Exhibit H

Memo to: Mr. S. S. Dennis III

From: Peter Townsend

Subject: Notes of discussions with Mr. Ivan Landreth on 11/15/77.

1. Mr. Landreth indicated that the advance of \$130,000 made in October 1977 to the corporation from Mr. S. S. Dennis III was used approximately as follows:

Pay off Mr. Landreth's \$20,000 note plus interest	23,000
Capital Expenditures:	
Warren and Brewster - 2 months engineering fees	17,040
Warren and Brewster - Maxi Mill progress payment	48,000
Stack Steel	9,998
Consolidated Electric - wiring	4,342
Wells and Wade - hardware	806
Bearings Incorporated	407
Transport Clearings	319
Milca	1,292
Welder rent	250
Small items	<u>341</u>
Payroll, operating expenses, quarterly payroll taxes, etc.	44,207
	<u>\$ 130,000</u>



2. Mr. Landreth gave the following estimated capital expenditure figure for the completed mill:

A) ITEMS PAID THRU 11/15/77:

General ledger postings thru 11/15/77 (cash paid)	676,000
Extra items in Para 1 above	<u>82,792</u>
	\$ <u>758,792</u>

B) ITEMS TO BE PAID AFTER 11/15/77:

Warren and Brewster - Main Mill	72,514
Machinery Sales Company	10,400
Georgia Pacific Supply Co.	<u>3,305</u>
	86,219
3.3% Sales tax on \$86,219	<u>4,570</u>
	90,789

Warren and Brewster-Plant Engineering Contract	* 17,000
2 weeks labor thru 11/15/77	14,000
2 weeks labor thru 11/30/77	5,000
Contingencies	<u>10,000</u>
Total Payable after 11/15/77	\$ <u>136,789</u>
MR. LANDRETH'S GRAND TOTAL PROJECT ESTIMATE	\$ <u>895,582</u>

(This compares with his 9/30/77 total estimate of \$864,632.)

D-274174  
NUMBER

[SEAL]

DOMESTIC

STATE OF WASHINGTON  
DEPARTMENT OF STATE

BRUCE K. CHAPMAN, Secretary of State of the State of Washington and custodian of its seal, hereby certify that

ARTICLES OF MERGER

LANDRETH TIMBER COMPANY, INC. domestic corporation of Tonasket, Washington (Merged with B&D COMPANY, Inc. (Delaware corp. not qualified in Washington)), was filed for record in this office at 8:00 o'clock a.m., on this date, and further certify that such Articles remain on file in this office.

In witness whereof I have signed and have affixed the seal of the State of Washington to this certificate at Olympia, the State Capitol, November 29, 1977.

/s/ Bruce K. Chapman  
BRUCE K. CHAPMAN  
Secretary of State

ARTICLES OF MERGER  
of  
LANDRETH TIMBER COMPANY, INC.  
(a Washington corporation)  
into  
B&D COMPANY, INC.  
(a Delaware corporation)

[Filed Nov. 29, 1977]

Pursuant to the provisions of Section 23A.20.050 of the Revised Statutes of Washington, as amended, B&D COMPANY, INC (the "Parent"), a corporation organized under the laws of the State of Delaware and owning all of the outstanding shares of LANDRETH TIMBER COMPANY, INC. (the "Subsidiary"), a corporation organized under the laws of the State of Washington, hereby executes the following Articles of Merger:

1. The adoption by the Parent of the Agreement and Plan of Merger attached to these Articles of Merger as *Exhibit A* (the "Agreement and Plan of Merger") was approved by resolutions of the Board of Directors of the Parent adopted November 11, 1977.

2. The number of outstanding shares of the only class of the Subsidiary's authorized capital stock and the number of shares of that class owned by the Parent (the surviving corporation following the merger contemplated by the Agreement and Plan of Merger) is:

Class	Number of Shares Outstanding	Number of Shares Owned by Parent
Common Stock, \$100 par value	500	500

3. The mailing of the Agreement and Plan of Merger was waived by the Parent as the sole stockholder of the Subsidiary.

4. The laws of the State of Delaware, under which the Parent is organized, permit the merger contemplated by the Agreement and Plan of Merger.

5. Simultaneously with the filing of these Articles of Merger the Parent has caused to be filed with the Secretary of State of Washington the documents required by Section 20.070 of the Business Corporation Act of Washington regarding its transaction of business in Washington as a foreign corporation.

6. The Parent hereby (a) agrees that it may be served with process in the State of Washington in any proceeding for the enforcement of any obligation of the Subsidiary and in any proceeding for the enforcement of the rights of a dissenting shareholder of the Subsidiary against the Parent; (b) appoints the Secretary of State of Washington as its agent to accept service of process in any such proceeding; and (c) agrees that it will promptly pay to the dissenting shareholders of such domestic corporation the amount, if any, to which they shall be entitled under the provisions of the Washington Business Corporation Act with respect to the rights of dissenting shareholders.

IN WITNESS WHEREOF, the Parent has caused two duplicate originals of these Articles of Merger to be executed in its name by its President and Secretary, this 17th day of November, 1977.

B&D COMPANY, INC.

By /s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
President

By /s/ Ruth A. Weymouth  
RUTH A. WEYMOUTH  
Assistant Secretary

STATE OF WASHINGTON )  
 ) ss.  
 COUNTY OF KING )

Before me, JACK G. STROTHER, Notary Public in and for the said County and State, personally appeared Samuel S. Dennis 3d, who acknowledged before me that he is the President of B&D COMPANY, INC., a Delaware corporation, and that he signed the foregoing document as his free and voluntary act and deed for the uses and purposes therein set forth.

In witness whereof I have hereunto set my hand and seal, this 17th day of November, 1977.

My commission expires September 10, 1981.

/s/ Jack G. Strother  
 Notary Public

# EXHIBIT A

## AGREEMENT AND PLAN OF MERGER

of

LANDRETH TIMBER COMPANY, INC.  
 (a Washington corporation)

into

B&D COMPANY, INC.  
 (a Delaware corporation)

AGREEMENT OF MERGER, dated November 17, 1977, between B&D COMPANY, INC. (the "Parent" and, after the merger referred to below, the "Surviving Corporation"), a Delaware corporation, and LANDRETH TIMBER COMPANY, INC. (the "Subsidiary"), a Washington corporation.

## WITNESSETH:

WHEREAS, the board of directors of each of the Parent and the Subsidiary, to the end that greater efficiency and economy in the business now separately carried on by each of these corporations may be accomplished, deem it advisable and to the benefit of each of these corporations and their respective stockholders that the Subsidiary be merged into and with the Parent;

WHEREAS, the Parent, by its certificate of incorporation filed in the office of the Secretary of State of Delaware on November 4, 1977, and submitted for recordation in the office of the Recorder of Deeds for the County of New Castle of the State of Delaware on November 4, 1977, has an authorized capital stock consisting of One Hundred Thousand (100,000) shares of Class A Common Stock, \$2.00 par value, and Twenty-Five Thousand (25,000) shares of Class B Common Stock, \$.40 par value, of which stock Eighty-Five Thousand (85,000) shares of Class A Common Stock and



Fifteen Thousand (15,000) shares of Class B Common Stock are now issued and outstanding and such shares shall remain issued and outstanding;

WHEREAS, the Subsidiary, by its articles of incorporation which were filed in the office of the Secretary of State of Washington on October 25, 1955, has an authorized capital stock consisting of a single class of One Thousand (1,000) shares of common stock, \$100 par value, of which stock Five Hundred (500) shares are now issued, outstanding and owned by the Parent; and

WHEREAS, the registered office of the Parent in the State of Delaware is located at 100 West Tenth Street in the City of Wilmington, County of New Castle, and the name of its registered agent at such address is The Corporation Trust Company; and the principal office of the Subsidiary in the State of Washington, is located at City of Tonasket, County of Okanogan,

NOW, THEREFORE, the Parent and the Subsidiary agree that the Subsidiary be merged into and with the Parent, and agree that the terms and conditions of the merger, and the mode of carrying it into effect be as follows:

#### ARTICLE I. CERTIFICATE OF INCORPORATION

Article FIRST of the Parent's Certificate of Incorporation will be amended upon consummation of the merger to read as follows: "The name of the Corporation is Landreth Timber Company, Inc." The Parent's Certificate of Incorporation as thus amended and otherwise as in effect on the effective date of the merger will continue in full force and effect as the Certificate of Incorporation of the Surviving Corporation.

#### ARTICLE II. BY-LAWS.

The by-laws of the Parent as in effect on the effective date of the merger shall be and remain the by-laws of the Surviving Corporation until they are altered, amended or repealed as therein provided.

#### ARTICLE III. PRINCIPAL OFFICES.

The principal offices of the Surviving Corporation are and shall be located (a) in the State of Washington, at \_\_\_\_\_, in the City of Tonasket, County of Okanogan, and (b) in the State of Delaware, at 100 West Tenth Street, City of Wilmington, County of New Castle.

#### ARTICLE IV. BOARD OF DIRECTORS: OFFICERS.

The board of directors of the Surviving Corporation on the effective date of the merger shall consist of the following persons (presently the directors of the Parent), who shall serve until their respective successors are elected or appointed according to the by-laws:

Name	Address
John Bolten, Sr.	Standex International Corporation Manor Parkway Salem, N.H. 03079
Samuel S. Dennis, 3d	52 Essex Road Chestnut Hill, MA 02167

The officers of the Surviving Corporation on the effective date of the merger shall consist of the following persons (presently the officers of the Parent) who shall serve until their successors are elected or appointed according to the by-laws:

Office	Name	Address
Chairman of the Board	John Bolten, Sr.	Standex International Corporation Manor Parkway Salem, N.H. 03079
President and Treasurer	Samuel S. Dennis 3d	52 Essex Road Chestnut Hill MA 02167
Secretary	Jack G. Strother, Esq.	
Assistant Secretary	Ruth A. Weymouth	75 Elmwood Park #24 Wollaston, MA 02170

# ARTICLE V. NO CONVERSION OF SHARES OF THE SUBSIDIARY; OUTSTANDING SHARES OF THE SURVIVING CORPORATION

On the date of the merger, all of the issued shares of the Subsidiary will be surrendered and cancelled, and there will be no conversion of any shares of the Subsidiary into shares of the Surviving Corporation. On the date of the merger, the total number of issued and outstanding shares of common stock of the Surviving Corporation will remain Eighty-Five Thousand (85,000) shares of Class A Common Stock and Fifteen Thousand (15,000) shares of Class B Common Stock.

# ARTICLE VI. TERMS AND CONDITIONS OF MERGER.

On the effective date of the merger, the Parent, as the Surviving Corporation, in addition to the assets and rights it itself possesses, will be possessed of all the property, rights, privileges, powers, franchises, patents, trademarks, licenses, registrations and other assets of every kind and description of the Subsidiary; and the full right to all such assets will be vested in the Surviving Corporation without its further act or deed and they will be its property as they were of the Subsidiary, and the title to any real estate, whether by deed or otherwise, now vested in the Subsidiary, will not revert or be in any way impaired by reason of this merger. On the effective date of the merger, the Surviving Corporation will be subject to all disabilities and restrictions applicable to the Subsidiary, and all rights of creditors, and all mortgages and other liens upon the property, of the Subsidiary, will be preserved unimpaired, and all debts, liabilities and duties of the Subsidiary will attach to the Surviving Corporation and be enforceable against it to the same extent as if such debts, liabilities and duties had been incurred or contracted by it.

# ARTICLE VII. EFFECTIVE DATE.

The merger will become effective upon the filing of this Agreement and Plan of Merger and all other documents required by law to be filed in connection herewith with the Secretaries of State of Washington and Delaware.

# ARTICLE VIII. TERMINATION OR ABANDONMENT.

Anything herein or elsewhere to the contrary notwithstanding, this Agreement and Plan of Merger may be terminated and abandoned by the board of directors of either the Parent or the Subsidiary at any time prior to the date of the filings contemplated by Article VII.

IN WITNESS WHEREOF, the undersigned, thereunto duly authorized, have hereto signed their names and affixed the seals of the Parent and the Subsidiary, this 17th day of November, 1977.

[CORPORATE SEAL]

B&D COMPANY, INC.

By /s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
President

ATTEST:

/s/ Ruth A. Weymouth  
RUTH A. WEYMOUTH  
Assistant Secretary

[CORPORATE SEAL]

LANDRETH TIMBER COMPANY, INC.

By /s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
President

ATTEST:

/s/ Ruth A. Weymouth  
RUTH A. WEYMOUTH  
Assistant Secretary

[CORPORATE SEAL]

RESIGNATION OF OFFICERS  
OF  
LANDRETH TIMBER COMPANY, INC.

The undersigned Officers as herein designated to wit:

President                   IVAN K. LANDRETH

Vice-President           LUCILLE LANDRETH

Secretary-Treasurer   LUCILLE LANDRETH

do each hereby resign their respective office in LANDRETH TIMBER COMPANY, INC., as above designated effective November 17, 1977.

/s/ Ivan K. Landreth  
IVAN LANDRETH

/s/ Lucille Landreth  
LUCILLE LANDRETH

RESIGNATION OF DIRECTORS  
OF  
LANDRETH TIMBER COMPANY, INC.

The undersigned, each being a Director of LANDRETH TIMBER COMPANY, INC., and constituting the entire present Board of Directors do each hereby resign as such Director effective November 17, 1977.

/s/ Ivan K. Landreth  
IVAN K. LANDRETH

/s/ Lucille Landreth  
LUCILLE LANDRETH

/s/ Thomas Edward Landreth  
THOMAS EDWARD LANDRETH



HALE AND DORR  
Counsellors at Law  
28 State Street  
Boston, Massachusetts 02109

November 4, 1977

Mr. Jack P. Branch  
Timber West, Inc.  
300 120th Street, N. E.  
Bellevue, Washington 98004

Re: *Landreth Timber Company, Inc.*

Dear Mr. Branch:

Sam Dennis has asked me to send to you, and I enclose herewith, Class B Common stock certificates of B & D Company, Inc. (the "Company") issued to the following persons:

Name	Number	Shares
Jack P. Branch	B-1	3,600
Troy N. Beaver	B-3	2,600
Troy N. Beaver, Jr.	B-4	2,600
Robert E. Branch	B-5	2,600

The stock certificates are legended to reflect certain provisions of the Company's Certificate of Incorporation and By-Laws, a copy of which provisions is enclosed for each investor.

As you know, the Rainier Bank and The First National Bank of Boston will require all the above stock certificates to be delivered to them at the closing, together with stock powers in the form enclosed and further stock powers in the Company's new name, Landreth Timber Company, Inc., which are also enclosed.

Would you please circulate to each of the other Class B stockholders listed above the package with his name on

it enclosed herein, consisting of his stock certificate, extracts from the charter and by-laws, both his stock transfer powers, and a copy of this letter. At the closing we will need to receive back from each person the stock certificate and both signed stock transfer powers.

Also, would you and each of the other persons sign and return one counterpart of this letter in order to acknowledge receipt hereof.

Thank you for your assistance in this matter.

Sincerely yours,

/s/ Edward Young  
EDWARD YOUNG

Enclosures

The undersigned hereby  
acknowledges receipt of  
this letter and the en-  
closures referred to above:

/s/ Jack P. Branch  
JACK P. BRANCH

/s/ Troy N. Beaver  
TROY N. BEAVER

/s/ Troy N. Beaver, Jr.  
TROY N. BEAVER, JR.

/s/ Robert E. Branch  
ROBERT E. BRANCH

### ASSIGNMENT AND ACCEPTANCE OF ASSIGNMENT AND ASSUMPTION

Pursuant to Section 3(b) of a Stock Purchase Agreement dated October 6, 1977 by and among Ivan K. Landreth, Thomas E. Landreth, Ivan K. Landreth, Jr., Landreth Timber Company, Inc. and Samuel S. Dennis 3d, said Samuel S. Dennis 3d hereby certifies that he has taken all steps contemplated in and required by said Section 3(b) to organize the corporation referred to in said Section 3(b) for whose use, benefit and advantage and on whose behalf said Samuel S. Dennis 3d entered into the said Stock Purchase Agreement solely as an accommodation party. Therefore, as contemplated and required by said Section 3(b), Samuel S. Dennis 3d hereby assigns to B & D Company, Inc., a Delaware corporation, all of his rights and obligations in, to and under the said Stock Purchase Agreement, with the effect set forth in said Section 3(b).

Executed as a sealed instrument as of this 7th day of November, 1977.

/s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D

The undersigned B & D. Company, Inc. hereby represents and warrants to the several parties to the Stock Purchase Agreement that, as contemplated by said Section 3(b), it is validly organized and existing and has all the power and authority necessary to carry out and perform the Stock Purchase Agreement.

The undersigned hereby accepts the assignment by Samuel S. Dennis 3d set forth above of all his rights and obligations in, to and under the Stock Purchase Agreement. The undersigned expressly assumes all such obligations of Samuel S. Dennis 3d and by this instrument agrees to be substituted as the Buyer (as that term is defined in the Stock Purchase Agreement) with the same legal effect as

though the undersigned and not Samuel S. Dennis 3d had been the original party to the Stock Purchase Agreement.

Executed as a sealed instrument as of this 1st day of November, 1977.

B & D. COMPANY, INC.

By /s/ John Bolten, Sr.  
JOHN BOLTEN, SR.  
Chairman of the Board

## Attachment D

## LANDRETH TIMBER COMPANY, INC.

*Action of Sole Director*

The undersigned, being the sole Director of LANDRETH TIMBER COMPANY, INC., a Washington corporation, and acting in accordance with Sections 08.345, 20.050 and 20.070 of the Business Corporation Act of the State of Washington hereby adopts the following resolutions:

RESOLVED, that the following persons be and hereby are elected to the respective offices set forth opposite their names below, to serve until their respective successors are duly elected and qualified or until their prior resignation or removal:

Chairman of the Board:	John Bolten, Sr.
President:	Samuel S. Dennis 3d
Treasurer:	Samuel S. Dennis 3d
Secretary:	Jack G. Strother
Assistant Secretary:	Ruth A. Weymouth

RESOLVED, that LANDRETH TIMBER COMPANY, INC. (the "Company") enter into an Agreement and Plan of Merger in the form attached hereto as *Exhibit A* (the "Agreement and Plan of Merger"), and that the President of the Company is authorized to execute and deliver the Agreement and Plan of Merger in the name and on behalf of the Company and under its corporate seal;

RESOLVED, that upon the terms and conditions, and in the mode, set forth in the Agreement and Plan of Merger, the Company merge itself into its sole stockholder, B & D COMPANY, INC., a Delaware corporation; and

RESOLVED, that the President and Assistant Secretary of the Company are directed to execute Articles of Merger in the form attached hereto as *Exhibit B* (the "Articles of Merger"), respecting the merger of the Company into B & D COMPANY, INC., and to cause the Articles of Merger to be filed with the Secretary of State of Washington, and to do all such acts and things as any of them may deem necessary or desirable to effect such merger.

RESOLVED, that the Merger shall be effected upon the later of the date of filing of the Articles of Merger with the Secretary of State of Washington and the date of filing by B & D Company, Inc. of a Certificate of Ownership and Merger with the Secretary of State of Delaware.

RESOLVED, that this corporation adopt and hereby does adopt, in connection with the merger, the plan for the distribution of all the assets of this corporation to B&D Company, Inc. which is set forth as Article VI of the Agreement and Plan of Merger; it being the intention of this corporation that such Article VI constitute a plan of liquidation within the meaning of Section 334(b)(2)(A) of the Internal Revenue Code of 1954, as amended.

WITNESS my hand and seal this — day of November, 1977.

/s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
Sole Director



Attachment E  
TIMBER WEST, INC.

October 20, 1977

Mr. Samuel S. Dennis, 3rd  
Hale and Dorr  
Counselors at Law  
28 State Street  
Boston, Mass.

Re: General Manager

Dear Sam:

I narrowed the search down to three people:

- 1) Rod Black
- 2) Phil Cook
- 3 Virgil Clark

All three of these people's resumes are attached.

I feel Rod Black is the number one choice on the basis of experience and over-all General Manager capabilities. He has been in the mill business and is very familiar with it and has the best total P & L responsibility. He is strong in sales and though not totally experienced in maxi-mills or computer mills, he has operated the sophisticated electronics incorporated in this type of mill. I would expect a \$40,000 approximate salary with some reasonable bonus arrangement. I personally would expect this to equate to probably \$10,000. He has 25 years in the business and would be my number one choice. However, in his position, he requests 30 days to terminate and this could potentially cause a mild problem with Ivan although I do believe he will accommodate us accordingly.

Next, my second recommendation is Mr. Phil Cook of Afton, Wyoming who is ready to go to work immediately and after a check of his references, I am confident he could do our job.

He has good P & L experience and responsibilities and I frankly would be very comfortable with him in our General Manager position. His anticipated salary would be in the approximate area of \$35,000 with some bonus arrangement. I feel this is in keeping with the industry standards and what we will have to pay as the going rate.

My number three recommendation would be Mr. Virgil L. Clark, who is currently a forest manager consultant while liquidating a corporation and has had extensive mill background, but I feel his age (64) would be not in keeping with our over-all picture and yet I would not want this to deter from his over-all qualifications. In fact, he may well be over-qualified, but nevertheless, a good candidate.

I would like to have your response to these three people and if you will call me at your convenience, I would appreciate it.

Respectfully your,

TIMBER WEST, INC.  
/s/ Jack P. Branch  
JACK P. BRANCH  
President

JPB:jmk  
Enc.

cc: 175 Washington Street  
Duxbury, Mass. 02332  
cc: Al Willard  
cc: Bob Ingram

## TIMBER WEST, INC.

October 27, 1977

Mr. Ivan Landreth  
Landreth Timber Company, Inc.  
Tonasket, WA 98855

Re: Mill General Manager

Dear Ivan:

After a very careful and deligent (sic) search, we have found what we consider a very capable General Manager to act on our behalf at the mill after closure. This gentleman is Mr. Phil Cook who will personally deliver this letter to you and since you gentlemen already know each other, this is more or less our informal introduction of Phil to you as our General Manager.

Phil's recommendations have come extremely high and he also had a very responsive visit with Bob Ingram at Rainier Bank and Bob's appraisal was equally good. I had Phil talk to Mr. Sam Dennis yesterday and it was after this discussion and my own personal recommendations that it was mutually agreed Phil Cook would be our man.

I would appreciate your extending all courtesies to Phil in any interim meetings that you will have with him prior to our formal take over on our closing date of November 4th.

After our conversation this morning, I do concur with you a two-day meeting this Saturday and Sunday in private will allow you to take Phil through the full mill situation and we would appreciate as thorough a job as is possible within that limited time.

As per our schedule generally agreed upon this morning by phone, we would expect to fly into Tonasket on Saturday, November 5th to meet with you at the airport in

Omak approximately 9:00 A.M. We would drive to the mill and meet with Phil, yourself and George for perhaps two hours in a top level meeting and acknowledge the transition to George at this point.

If it is permissable, and I feel this is very important, I would like to request that you invite all of the key people to a luncheon at the restaurant we had lunch in on our visit and reserve a meeting room or luncheon room if possible. We would then introduce Mr. Dennis, Phil Cook, and myself, and re-assure all parties that there will be no changes. At this meeting, we would anticipate making some salary adjustments as per our conversation, but we will discuss this and other matters with Mr. Dennis next week at the preliminary closing.

Ivan, I would like to take this time to give you my personal thanks for your cooperation in all of the very difficult matters that have arisen within this past three months. You have handled yourself with appropriate dignity and your confidence and general appreciation for the situation has been clearly appreciated. I would also like to compliment you on being a true gentleman and man of your word and I certainly appreciate all of these and many other efforts you have extended to me, Gene Graf, and Mr. Sam Dennis. We do not expect this to be our last association and look forward to a pleasant transition and years of pleasant relationship together.

Respectfully yours,

TIMBER WEST, INC.  
/s/ Jack P. Branch  
JACK P. BRANCH  
President

JPB:jmk

cc: Sam Dennis  
John Bolten  
Phil Cook

## LANDRETH TIMBER COMPANY, INC.

*Certificate of President*

The undersigned certifies that he is the duly-elected and qualified President of Landreth Timber Company, Inc., and pursuant to a written consent of all of the Directors of Landreth Timber Company, Inc., dated as of November 17, 1977, the following resolution was adopted by Landreth Timber Company, Inc.

**RESOLVED:** That Philip A. Cook, as General Manager of the Company's operations, is hereby designated and authorized as the Company's representative to deal with the United States Forest Service and to execute all documents in connection with timber cutting contracts and any and all matters between the Forest Service and the Company.

IN WITNESS WHEREOF, the undersigned has set his hand this November 17, 1977.

/s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D

## Attachment E-1

## TIMBER WEST, INC.

December 19, 1977

Mr. Phil Cook  
General Manager  
Landreth Timber Company  
Tonasket, WA 98855

Re: Stock purchase Landreth Timber Company

Dear Phil:

I would like to take this letter to clarify the situation with respect to Ivan Landreth's position and situation with the company at this time.

Ivan Landreth and his sons have sold 100% of the stock of Landreth Timber Company to B & D Corporation which subsequently will change its name back to Landreth Timber Company. Ivan Landreth has no stock whatsoever in the company and has been retained on an interim basis for perhaps one to three months as a consultant on matters relating to the orderly transition in sales, contracts, customers, etc. In the event any of your personnel have any vague notions or concerns as to whether Ivan is still involved in the company, please be sure that he is not and although he is still around the mill, more or less tidying up his affairs, we will have no further use for his services in a short period of time.

The principal stock holders are Sam Dennis and John Bolton of Boston, Massachusetts and my group is a minority holder.



Should you have the need to show this letter to any interested party, please feel free to do so.

Respectfully yours,

TIMBER WEST, INC.

/s/ Jack P. Branch  
JACK P. BRANCH  
President

JPB:jmk  
cc: Sam Dennis  
John Bolton

November 17, 1977

Supervisor  
Colville National Forest  
Forest Service U.S.D.A.  
Colville, Washington 99114

Dear Sir:

This will introduce Mr. Philip A. Cook, who is the new General Manager of all operations at Landreth Timber Company, Inc. A small group of individuals, of whom the undersigned is controlling stockholder, has acquired Landreth Timber Company, Inc., effective November 17, 1977. We plan to operate the mill on a full-time basis, year-round, and will, of course, perform all contracts with the U.S. Forest Service in accordance with their terms. With the exception of Mr. Cook, we anticipate continuing the operation with the same supervisory personnel as in the past.

If you would like further information about the new owners, Mr. Thomas Wood at the Rainier National Bank, Seattle, would be glad to hear from you. (His telephone number is 621-5412.) Mr. Cook can arrange to get any other information you would like to have.

We look forward to working with the Forest Service in the future, and will much appreciate any cooperation you can give to us.

Respectfully,

LANDRETH TIMBER COMPANY, INC.

By /s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
President

## Attachment F

GRAHAM & DUNN  
Attorneys at Law

March 3, 1978

Mr. Ivan K. Landreth  
Oroville, Washington 98844

Dear Mr. Landreth:

This letter follows up your letter of January 16, 1978, enclosing your check no. 125 payable to Landreth Timber Co. Inc., dated January 14, 1978, in the amount of \$369.81 covering credit card charges on the Company Chevron credit card, which were charged by you after the closing of the sale of the Company's stock. We have been instructed by our client to return your check to you pending the resolution of all outstanding claims in connection with the purchase of the mill. For your information, the Chevron statement covering your charges has been paid by the Company.

Very truly yours,

JACK G. STROTHER

JGS/1fb

cc: Samuel S. Dennis, 3d  
Edward T. Engst

Box 487  
Oroville, Wash  
98844  
Jan. 16, 1978  
- Jack Strother

I am sending herein check for gas purchased made by me on Landreth Timber Co. Inc. Standard credit card. At the time charges there I didn't know my service would be terminated.

Before leaving on our trip I had made arrangements with Vivian in the office that any charges I made before November 1st were for company account and any charges made after that were for my account; be a payroll deduction from my wages. There are no charge tickets included in company acct and one check dated 5/23/78 - that

is a company which  
this charge is made on  
123/77 and Standard Oil  
is never billed it, but  
no doubt will in May.

8. The \$185.67 ticket dated 11/17  
for snow tires is included  
in the check. They were  
purchased after the mill  
closing and were needed  
to negotiate the mountain.  
as you will recall  
it was snowing in Seattle  
and a blizzard on the pass.

I tried to give this  
check to Phil Cook this  
morning and he refused  
to accept it. I can't  
understand what is  
taking place!

On my termination I  
relinquished my credit card  
and office key to Phil Cook,  
also at that time I found

that my own desk had  
been completely emptied  
out and had been removed  
from the office building.  
Some of my personal property  
has been returned to me  
long with the desk, but  
I did not receive the  
contents of one desk drawer  
which contained personal  
valuable papers.

I have asked Phil for  
these and he claimed  
he does not have them.  
The whereabouts of these  
papers are of great concern  
to me.

I consider it highly  
improper and unethical  
for Phil or anyone to  
have entered my desk  
and removed the  
contents.

Sincerely,  
Don H. LaBelle



## CONSULTING AND NONCOMPETITION AGREEMENT

Effective as of November 17, 1977, B&D Company, Inc. (the "Company"), a Delaware corporation, and Ivan K. Landreth (the "Consultant") agree as follows:

### 1. *Consulting Arrangement.*

1.1. *Consulting Period.* The Company shall employ the Consultant as a consultant to the Company for a period of one (1) year commencing on the date of this Agreement (such period, as it may be extended, the "Consulting Period").

1.2. *Consulting Duties, etc.* The Company shall employ the Consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the Consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as a consultant to the Company in connection with such participation and for such purposes.

### 2. *Compensation.*

2.1. *Compensation During Consulting Period.* The Company shall pay the Consultant monthly at the rate of Two Thousand Five Hundred Dollars (\$2,500) per month for the first six (6) months of the Consulting Period and at the rate of One Thousand Dollars (\$1,000) per month for the second six (6) months of the Consulting Period.

2.2. *Reimbursement of Costs and Expenditures.* Consultant will be reimbursed for his reasonable costs and expenses in connection with the performance of services specifically requested by the Company upon reasonable

substantiation and approval by the Company of such costs and expenses.

3. *Noncompetition.* At all times during the Consulting Period and for a period of three (3) years after termination of the Consulting Period, the Consultant shall not, directly or indirectly, as an employee of any person or entity (whether or not engaged in business for profit), individual proprietor, partner, stockholder, director, officer, joint venturer, investor, lender or in any other capacity whatever, compete with the business of the Company or any subsidiary of the Company (each such subsidiary, a "Company Subsidiary"). As used in this Agreement, "compete", "competition" or any variation thereof, means engagement or participation of the Consultant in, or his furnishing aid or assistance in connection with, the design, manufacture, distribution, sale, marketing or rendering of products or services of the type and kind designed, manufactured, distributed, sold, marketed or rendered by the Company or any Company Subsidiary in the Consulting Period or in the one-year period preceding the Consulting Period, including, but not limited to, those products or services the Company or any Company Subsidiary, as the case may be, was then in the process of developing or designing for manufacture, sale, marketing or rendering in the States of California, Idaho, Oregon, Washington and Wyoming.

4. *No Solicitation of Employees.* At all times during the Consulting Period and for a period of three (3) years after termination of the Consulting Period, the Consultant shall not, directly or indirectly, or by any act in concert with others, employ, attempt to employ, recruit or otherwise solicit or induce or influence to leave his employment any employee of the Company or any Company Subsidiary for any purpose. The restrictions described in this Section 4 are applicable in the States of California, Idaho, Oregon, Washington and Wyoming.

5. *No Disclosure of Information.* The Consultant shall not at any time divulge, use, furnish, disclose or make accessible to anyone other than the Company or a Company Subsidiary or their respective directors or officers any knowledge or information with respect to (a) confidential or secret processes, plans, formulas, data (including cost data), machinery, drawings, specifications, manufacturing procedures and techniques, methods, technology, know-how, programs, devices or material relating to the business, products (whether existing or under development), services or activities of the Company or any Company Subsidiary; (b) any confidential or secret engineering, research, development or other original work of the Company or any Company Subsidiary; (c) any other confidential or secret aspects of the business, products or activities of the Company or any Company Subsidiary; or (d) any customer usages and requirements or any customer lists of the Company or any Company Subsidiary. All records, materials and information obtained by the Consultant in the course of his employment by the Company shall be deemed confidential and shall remain the exclusive property of the Company. This provision shall not apply to any information which at any time comes into the public domain other than as a result of the violation of the terms of this Section 5 by the Consultant.

6. *Enforceability.* The Company and the Consultant recognize that any breach by the Consultant of any of his obligations under Sections 3 and 4 would result in irreparable injury and damage to the overall reputation of the Company and to its business and affairs. The Company and the Consultant therefore consider the restrictions contained in Sections 3 and 4 to be reasonable as to the covenants of, and the duties and restrictions imposed on, the Consultant therein, whether in terms of extent, time or geographic area. However, if any such covenants, duties or restrictions are found by

any court having competent jurisdiction to be unreasonable because they are (or any one of them is) too broad, then those covenants, duties or restrictions shall nevertheless remain effective, but shall be considered amended as to extent, time or geographic area (or any one of them, as the case may be) in whatever manner is considered reasonable by such court, and as so amended shall be enforced.

7. *Relief in Case of Breach.* The services to be rendered by the Consultant to the Company in the Consulting Period are unique and extraordinary, which gives them a value peculiar to the Company; and the Company cannot be reasonably or adequately compensated in damages for their loss. Accordingly, any breach by the Consultant of the terms of this Agreement, including, but not limited to, the terms of Sections 3 and 4, will cause the Company irreparable injury and damage. Therefore, the Company shall be entitled, in addition to all other remedies available to it, to injunctive and other available equitable relief in any court of competent jurisdiction to prevent or otherwise restrain a breach of this Agreement, without notice to the Consultant, for the purpose of enforcing this Agreement or any of its terms.

8. *Termination of Employment.* All employment of the Consultant by the Company under this Agreement shall terminate on the earliest to occur of the following dates:

- (a) Upon expiration of the Consulting Period.
- (b) Upon the death or disability of the Consultant. For purposes of this Agreement, the Consultant shall be deemed disabled if he has been unable to render the services required to be rendered by him in the Consulting Period for thirty (30) consecutive days.
- (c) At the election of the Company, upon thirty (30) days' prior written notice.



9. *Payments Upon Termination.* If all employment of the Consultant by the Company under this Agreement is terminated, the Company shall pay the Consultant the compensation otherwise payable to him under Section 2 through the date of such termination,

10. *Miscellaneous.* This Agreement shall inure to the benefit of and be binding upon the Company and the Consultant and their respective successors, executors, administrators, heirs and permitted assigns; *provided* that the Consultant may not make any assignment of this Agreement or any interest therein, by operation of law or otherwise, without the prior written consent of the Company. This Agreement constitutes the entire agreement between the parties and may not be changed except by a writing duly executed and delivered by the Company and the Consultant in the same manner as this Agreement. This Agreement is governed by and shall be construed in accordance with the laws of the State of Washington. The Company and the Consultant may execute this Agreement in any number of counterparts, each of which is an original, but all of which shall constitute but one instrument. In proving this Agreement, it shall not be necessary to produce or account for more than one such counterpart. This Agreement supersedes in all respects any prior agreement between the Company and the Consultant relating to any of the subject matter hereof.

B&D COMPANY, INC.

By /s/ Samuel S. Dennis 3d  
SAMUEL S. DENNIS 3D  
Its President

/s/ Ivan K. Landreth  
IVAN K. LANDRETH

# ATTACHMENT H

LANDRETH TIMBER COMPANY, INC.

P.O. Box 505  
Tonasket, Wash. 98855  
Telephone 509-486-2134

[SEAL]

January 10, 1978

Mr. Ivan K. Landreth  
Oroville, Washington

You are hereby given thirty (30) days notice pursuant to Paragraph 8(c) of the Consulting and Noncompetition Agreement of November 17, 1977 that the Company elects to terminate your employment.

I have instructed Phil Cook to have a check prepared to compensate you through the thirty-day period as provided in Paragraph 9 of the Agreement. Please stop by Phil's office at your convenience to pick up your check.

LANDRETH TIMBER COMPANY, INC.

By /s/ Jack P. Branch  
JACK P. BRANCH  
Vice President



[SEAL]

## TIMBER WEST, INC.

November 21, 1977

Mr. Samuel S. Dennis, 3rd

Mr. John Bolton

Hale and Dorr

Counsellors at Law

28 State Street

Boston, Mass 02109

Re: Landreth Mill

Dear Sam and John:

As per our discussion, we made the transition Friday and although I ran into several minor things that needed straightening out, I do feel the transition went well.

As we suspected, there was a great amount of confusion among Ivan's men since they knew something was happening, but did not know precisely *what* was happening.

We had the luncheon with all the principal people and they were all much relieved to finally have the story straight and to have a definite goal or direction that they were going.

There were many small things that you could tell were done in an antiquated way (do it Ivan's way), and it was very gratifying to see a take-charge guy like Phil Cook showing his real leadership capabilities and literally snapping them to and starting to run the show like a real business. I do feel you can be proud of Phil Cook and his business-like manner and overall leadership.

This is a personal observation, but I believe we can be prepared for probably \$10,000 worth of over-run on the final start up costs that will result in accelerating the mill completion by from one to two weeks. In either

case, if this is true, it will be a valuable expenditure to gain the extra production.

As we discussed in our call Friday, we had Warren and Brewster to fly up Saturday morning for a general meeting to go over the various changes recommended by Warren and Brewster originally, but not put in motion by Ivan. Also Warren and Brewster is sending, at Phil's request, three skilled laborers to speed up the mill construction. These men are skilled in doing the assembly work, but this was part of the work Ivan's men were supposed to do, so this labor will be in excess of Ivan's original programmed cost, but should accelerate the Maxi-Mill's completion by one to two weeks.

There is also a shortage in small tools, and any number of things were not ordered, but Phil got the very bulk of these things ordered by phone before the day was over Friday.

Over-all I can summarize this commentary by saying the mill is in good hands with Phil Cook and it is my opinion that he will probably work 12 to 15 hours a day for the next month getting it shaped up and in production in an orderly and profitable manner. I do feel that by the time you two gentlemen come out next month, that you will see something you will truly be proud of. I can say after talking to Warren & Brewster, Phil Cook, Ivan, and Peter Townsend, that I do not have any concern as to whether the mill will reach the productivity and profits that we anticipated. I will talk to Phil from time to time and anticipate visiting the mill about each two weeks and keep you informed accordingly.

Respectfully yours,

TIMBER WEST, INC.

/s/ Jack P. Branch  
JACK P. BRANCH  
President

JPB:jmk

[SEAL]

## TIMBER WEST, INC.

November 28, 1977

Mr. Samuel S. Dennis, 3rd  
 Mr. John Bolton  
 Hale and Dorr  
 Counsellors at Law  
 28 State Street  
 Boston, Mass 02109

Re: Landreth Mill

Dear Sam and John:

I have just reviewed the past weeks progress with Phil Cook and I can tell you he has literally turned heaven and earth to get all of the many small problems worked out. The bulk of the problems were logistical in that Ivan was in and out of the mill and never clearly gave anyone any authority to do anything.

There were several minor problems with electrical hook-ups and Phil Cook has an electrician in today who can resolve all of those problems. The steel and associated equipment for the completion of the maxi-mill log deck has been ordered (it was not even designed prior to last (sic) week) and this material is in and will be completed on schedule.

The debarker on the Helle mill was out of alignment and that is being corrected this week and the Helle mill will start production at between 20,000 and 30,000 bd. ft. per day on Monday, December 5th. Phil will start and run it on a test basis this week, but production will not start until December 5th. The edger has been and is being reset and by the end of this week all functions of the mill have been debugged and in an operable position.

I have talked with Warren and Brewster and there is one more truck load of equipment due in this week (all fabricated) and the Maxi Mill will be in complete operational position between December 10th and December 15th. Phil has indeed made giant strides in this one week since he has been at the mill. The Warren and Brewster people were amazed at how much he has accomplished and were very complimentary to the fact the mill is now being operated as a good operation. They, as well as Phil, are super-optimistic on this being a very good producing mill.

Phil is reviewing a very good stand of timber and will be making preparations for bidding this next week. I will review this in more detail with you in my next report.

In conclusion, I would like to say you both can rest easy with the mill situation as it is. Peter Townsend is due in Tonasket today and I have talked with him over the weekend and I am confident he will set up the books in an appropriate manner. I will keep you posted accordingly.

Respectfully yours,

TIMBER WEST, INC.

/s/ Jack P. Branch  
 JACK P. BRANCH  
 President

JPB:jmk

GRAHAM & DUNN  
Attorneys at Law

December 1, 1977

Mr. Philip A. Cook  
General Manager  
Landreth Timber Company, Inc.  
Post Office Box 505  
Tonasket, Washington 98855

Dear Phil:

As you requested, I am enclosing the following items:

Certification of Disposition of Timber from National Forest Sale, covering Chucker Timber Sale, Contract No. 00899-7

Old National Bank of Washington Corporate Combined Checking and Savings Account signature card

Rainier National Bank (Oroville Branch) Corporate Resolutions for Signing and Endorsing Checks

Landreth Timber Company, Inc. has now been merged into B&D Company, Inc., a Delaware corporation, which changed its name to Landreth Timber Company, Inc. Consequently, I changed the name from B&D Company, Inc. in the Rainier Bank form to Landreth Timber Company, Inc. I also completed Paragraph 2 of the form to require your signature and the signature of George Morrell or Louis Zabreznik or Les Schertenleib. Both the ONB and Rainier accounts require your signature on all withdrawals and checks, together with one of the other three authorized signatures.

Let me know if I can be of any further assistance.

Very truly yours,

/s/ Jack  
JACK G. STROTHER

JGS/sw  
Enclosures

File No. 525-31-118

HALE AND DORR  
ORIGINAL FILE COPY  
Not to Leave the Office

December 1, 1977

Mr. Jack Branch  
Timber West Inc.  
300 - 120th Street N.E.  
Bellevue, Washington 98005

Dear Jack:

I acknowledge with thanks your letters of November 21 and 28 reporting to me on the situation at the Landreth Mill. I also talked to Phil Cook yesterday.

I am very pleased to hear and see that things are going well and delighted that Phil was able to bid in the State owned timber offering at a price which he considered satisfactory.

Mr. Bolten and I both appreciate your continuing interest and hope you will continue to go out there occasionally as you in your judgment deem it advisable. I would assume that if Phil is as good as we think he is, outside supervision will not have to be as intensive as time goes on. You should put in statements to the Mill to cover your expenses (with copies to me if convenient). Mr. Bolten and I will talk to you about the over-all financial situation when we see you.

When you report on the Mill operations in the future, Mr. Bolten would appreciate your sending his copy directly to him at his Palm Beach home. The address is: 165 Via Bellaria, Palm Beach, Florida 33480.

We hope to see you some time around the middle of January.

Best regards.

Sincerely,

S. S. DENNIS 3d



[SEAL]

## TIMBER WEST, INC.

December 6, 1977

Mr. Samuel S. Dennis 3rd  
 Mr. John Bolton  
 Hale & Dorr  
 Counselors at Law  
 28 State Street  
 Boston, Mass

Re: Start up of Helle Mill and general progress  
 Landreth Mill

Gentlemen:

I talked with Phil Cook yesterday and I am very pleased to advise that the Helle mill has started production as of Monday December 5th and though it was running slow, Phil advised that by the end of the day, it was running properly and at a rate of approximately 30,000 bd. ft. per eight-hour shift.

Phil advises that he will further test run it Tuesday on production and has a second crew coming to work Wednesday, December 7th (double shift). From that day on, we would expect a minimum of 60,000 bd. ft. per day of approximately \$200 material (rough green dimension lumber). This would be \$12,000 per day cash flow and including the over-run, would be equivalent to approximately \$100 per 1,000 profit.

Phil shipped out one carload last week (\$9,600) and a second carload was shipped out Monday night (approximately \$10,000 to \$12,000). The Maxi mill is on target and we anticipate start up production by December 15th. It will take four to five days to shake it down and it will then be able to produce at approximately 80,000 to 100,000 bd. ft. per day. Phil advises me that between the Helle and Maxi, we will have no problem producing

100,000 bd. ft. per shift and should be double shifting very shortly after the first of the year (presuming there are no major bugs in the Maxi mill start up). This would give us our production capacity of 200,000 bd. ft. per day and with the over-run capacity of the Maxi mill, the profits should easily exceed the anticipated figures of Phil Townsend.

As I recall from Peter Townsend's cash flow projection, we would not be going into double shift production before three months. In this case, we will be ahead of this schedule by nearly two months and accordingly start to catch up on some of the profit slippage due to some of the delays. All of the equipment except one truck load has arrived at the plant and that load is being pre-fabricated and will arrive early next week and will take only a minimum amount of time to assemble. All of the log deck and carriage are in and the electrical work is being finalled (most of it this week).

I have talked to Allen Lambert at Warren & Brewster and he is very well pleased with the cooperation he and his men are receiving and it is gratifying to see a job being well done. This credit belongs to Phil Cook and I would estimate he has spent an average of 12 hours plus per day since his first day. Yes, Sam, I do agree with both you and John that there would be no reason for outside supervision of Phil as I feel he is totally competent in every way. I am merely taking this time to keep both of you abreast of the progress as I see it since I am talking directly with Phil several times each week.

I reviewed the sales and private timber purchases Phil has made since taking over and I feel the job has been well done. However, we are at the crises point of extension of the credit line that allows him to start our own logging operation and build up of logs for the winter season. I anticipate talking to Phil in detail on this at the end of the week and will discuss this with you by

phone after I have some concrete figures. I will then give you my recommendations and conclusions for your submittal to Tom Woods and Rainier Bank for this additional credit line.

I wish both of you gentlemen to recognize that I am not trying to take a pre-emptive position in any of these matters, except that I am on the scene and more closely associated with the problem and I feel I can properly report them to you for your own execution.

Sam, I note in your last line of your letter of December 1, 1977, that you expect to see us around the middle of January. I would presume that you would not be here December 20th as we discussed, but please feel no fear in the over-all operation of the mill. It is a winner.

Respectfully yours,

TIMBER WEST, INC.

/s/ Jack Branch  
JACK BRANCH  
President

JPB:jmk

File No. 525-31-118

HALE AND DORR  
ORIGINAL FILE COPY  
Not to Leave the Office

December 7, 1977

Mr. Phillip Cook  
Landreth Timber Co., Inc.  
Tonasket, Washington 98855

Dear Phil:

On a related subject, I guess it is clear that we want to sell as much of our product as possible as lamstock in view of the large price differential. As I understand it, all lamstock must be kiln dried. If only about 20 to 25 million ft. of lumber can be processed through the kiln and 60% to 65% of our product could be sold as lamstock (the figure originally given me when we were looking at the Mill), there might be as much as 10 to 15 million ft. of lumber which could not be put through the kiln and would have to be sold at lower prices. I realize that the price differential right now between green and dried lumber is fairly small—\$10. to \$20. per thousand—and that an additional kiln will cost \$150,000 to \$500,000 depending on installation. However, at \$20. per thousand, the price difference on 10 million ft. would equal lost dollar sales and profits of \$200,000 annually before taxes. A \$200,000 kiln would be paid for in after tax dollars in two years on this basis.

I realize you have a tremendous amount to do and that this problem is not pressing. However, at some point in the fairly near future, I understand you are going to have someone look into this. When I talked to Pease sometime ago about this, he said that there were a number of ways to go varying greatly in cost and a

study should be made of this before deciding what to do. You may or may not want to talk to him and get his ideas before deciding what you are going to do.

Regards.

Sincerely,

S. S. DENNIS 3d

CC: Mr. John Bolten  
Mr. Jack Branch  
Mr. Peter Townsend

File No. 525-31-118

HALE AND DORR  
ORIGINAL FILE COPY  
Not to Leave the Office

December 7, 1977

Mr. Phillip Cook  
Landreth Timber Co., Inc.  
Tonasket, Washington 98855

Dear Phil:

I was glad to talk to you yesterday and learn that things are progressing well at the Mill. As I understand it, the Helle mill went into production the first of this week and you expect to have it on a double shift basis within a week or so with most of the bugs out of it. This should certainly start to produce substantial sales almost immediately where you have no problem selling all we can produce under present conditions.

I have given some further thought to what our overall financial policy should be at the Mill which, of course, is directly connected with the sales policy and would like to give you my thinking.

Obviously I think we should do everything possible to maximize dollar sales. Assuming an annual volume of production of between 40 and 50 million bd. ft. of saleable lumber, every extra \$1.00 per thousand feet amounts to between \$40,000 and \$50,000 extra dollar sales. These extra dollars are, of course, carried directly through to the bottom line as profits before taxes because they do not involve any additional expenses.

With the above in mind, it seems to me that as a matter of policy we should not give significant discounts for cash, etc. unless the lumber cannot be sold to someone at the prices without giving discounts (and unless,



of course, we have to have the money immediately and cannot get it from any other source). For example, assuming 40 million bd. ft. of sales a year and an average price of \$250. per thousand, annual sales would amount to about \$10,000,000. If a 5% discount were given on all of those sales, the result would be to reduce bottom line profits by \$500,000. To put this another way, assuming that the 5% cash discount means that we get our money from 20 to 30 days sooner, the 5% discount equals an interest rate of between 60% and 90% for the use of this money for the extra 20 or 30 days.

In making the above points, Phil (which I guess are pretty obvious), I am not being critical. I realize that I don't know much about this business yet and that good reasons may exist for giving discounts in getting rid of hard to sell lumber or for some other special reason with which I am not familiar. My only point is that done on a wide scale, it does involve sacrifice of a lot of profit and if not necessary because of conditions in the trade, we can obtain the money to finance our sales over normal payment periods a great deal cheaper.

I have also learned from exposure to other businesses with which I have had experience that it is better in the long run to have definite pricing policies and to avoid making price concessions unless it is absolutely necessary. I think customers tend to have more respect for your price structures and question them less if they are as uniform as possible consistent with current competitive prices in the industry. Since we appear to be in a strong sellers market at the present time, this should be a good time to establish such policies—and also to convince our customers that we are a substantial firm which is adequately financed.

I very much appreciate your concern about conserving cash, Phil, and I perhaps overemphasized this in talking to you. We are, of course, not going to have excess cash

for quite a long time so that cash conservation wherever practicable is very important. However, cash conservation at the expense of substantial profits should not be our policy if the financing is available. We will have a better handle on this after I get your and Peter Townsend's up to date cash estimates for the next two or three months. However, I believe financing can be arranged which will make it unnecessary to make price concessions through discounts or otherwise merely for the purpose of getting immediate cash.

I am encouraged by the continuation of the strong market situation for our products. In that connection, I am enclosing an interesting speech which a wholesale lumber friend of mine sent to me given by Senator Proxmire in the Senate on the market and price situation for lumber. You will note that the Forest Service and Council on Wage/Price Stability are projecting continued increases in the demand for lumber relative to the supply with a continuing increase in peak prices. Apparently there is some pressure on the Forest Service to modify their timber cutting policy to accommodate the supply curve and also to institute more efficient forestry operations. All of this, I would think, would help us in the long run.

Mr. Bolten asked to be remembered to you; we are both looking forward to seeing you between the middle and end of January and look forward to hearing from you as to the best time to come.

I should appreciate being kept informed of anything significant and would like to participate in any important decisions such as the purchase of more timber or of any substantial piece of equipment, changes in wage and salary rates, etc. I should appreciate it if you would not sign any check in excess of \$20,000 without giving me a ring or dropping me a note. Mr. Bolten would like to have copies of any letters and papers which you send to me.

I talked to Peter Townsend this morning who enjoys working with you. As you know, I am relying on him for financial-accounting type information and controls and am delighted that you both enjoy working with each other.

Best regards.

Sincerely,

S. S. DENNIS 3d

CC: Mr. John Bolten, Sr.  
Mr. Jack Branch  
Mr. Peter Townsend

[SEAL]

TIMBER WEST, INC.

December 12, 1977

Mr. Samuel S. Dennis 3rd  
Mr. John Bolton  
Hale & Dorr  
Counselors at Law  
60 State Street  
Boston, Mass

Re: Landreth Timber Company

Gentlemen:

After several lengthy conversations this past week with Phil Cook and the ensuing commitment to purchase a newly rebuilt edger, I felt a trip was necessary to give you gentlemen a first hand report.

First the Helle mill was in operation and for the most part the bugs were about out of it, but the edger was still giving problems and it was clearly evident that a more effective edger was needed when the Maxi mill starts production.

The new edger that Phil has negotiated for costs \$36,000, with the installation included, totaling approximately \$50,000. The payment of this will be approximately 50% down on completion of installation and the balance in 45 days.

The new edger is being gone over in the shop today, tomorrow and Wednesday, and will be shipped to Tonasket Thursday. It will be installed completely and in an operable position by Sunday night. Its installation will not interfere with the other edger or the Helle mill operation. This additional expense will give the mill a full double shift capacity (with no problems) of 250,000 bd.



ft. per day. Phil anticipates being able to reach this production level somewhere near January 15, 1978.

Lyle Warren and Allen Lambert of Warren & Brewster are at the mill today making sure all of the structural engineering and design lay-out is exact for the proper installation of the edger.

It was our prompt remittance in response to their billing that is getting such good service from these people where normally this installation would have delayed us probably two to three weeks longer. Phil has been working very well with them and the fact that we have made responsible decisions, they are convinced you gentlemen are real and the credibility of the whole operation has been established on a good plane.

The Maxi mill is still on schedule and should start up between the 15th and 20th of this month and I am confident that we will have the total resources of Warren and Brewster available to us for all of the debugging and start up. In fact, I believe now they will look at your mill as one of their best examples of a truly well run and put together operation instead of somewhat turning their back in the fouled up manner it would have been had Phil Cook not responded to certain changes they recommended in opposition to what Ivan's original plans were.

At this point, it is necessary to bring up the need for our logging inventory financing. First, Phil is anticipating double shifting the Maxi mill approximately the middle of January. This will cause an increased need for log inventory but it will also develop a tremendous amount of extra profit.

I discussed this matter thoroughly with Phil and attempted to call Peter Townsend today, but he is in a two-day seminar and I doubt I shall reach him until Wednesday. Phil will need approximately \$100,000 by December 19th. He will need an additional draw of up

to \$150,000 between December 25th and 30th; and a draw of up to an additional \$100,000 between January 1st and 15th. This totals \$350,000 for the total log inventory and this will include our build up of lumber inventory in the yard since that build up of inventory will come gradually and will come from profits. The reason for this acceleration on inventory is the tremendous amount of logs the Maxi mill will take once it starts, single, then double shift production.

Our biggest over-run will come from the Maxi and the sooner we get it into double shift, the more profit we will make. At the estimated 250,000 bd. ft. per day production, the Maxi will be doing 200,000 while the Helle is doing 50,000.

Phil is making preparations to start the kiln dryer and the planner this week and will be getting into the lamstock market as fast as scheduling would permit. The Helle mill seems to be pretty much debugged, but with the edger giving problems it has not produced at the expected level. This will change the first of next week with the installation of mercury lights for double shifting and the edger with no problems that would allow Helle 75,000 to 80,000 bd. ft. per day production.

There will no doubt be start up and debugging problems with the Maxi mill and with all of the cooperation we are getting from Warren & Brewster, I think these will be normal.

However, with the solving of one problem (the edger) and the start up of the Maxi mill, it is becoming increasingly evident we have an additional problem that Phil is investigating thoroughly at this point and I will report to you by phone and letter within the next two or three days. This problem involves the debarker and with the overall appraisal of production we are looking at, it appears that we will have to set in a separate debarker to feed the Maxi mill. I have no clear evalua-



tion of this dollar expense except that it would certainly be less than the edger and would not cause any significant change in its operation if we act fast.

My own guess from talking with Phil and George and Warren & Brewster is probably in the neighborhood of \$35,000. In either case, Phil has acknowledged that he will be running six days per week and double shifting at all times permissible (Christmas Eve, Christmas, New Year's etc. as exceptions). In this case, he will have virtually made up in additional production, the amount necessary to up grade this portion of the mill.

I can reasonably understand the undersizing of this equipment as related to what Ivan's prior production was in line with what our expectations are and Phil's capability of running the mill at maximum production. I know it is difficult to look at extra expenditure items with each report, but I can conclusively say, that these items are all cost effective to increased production and profits, and Phil simply will run the operation the extra hours and days to make up for these expenses. In fact, they will represent only a few days of production after we are fully started up and yet they will have increased the production capacity of the mill fully 25% if it could have ever been at the 200,000 bd. ft. per day figure at all.

The kiln dryer situation will be handled with appropriate engineering studies after the Maxi is in production and whatever outside sources are needed that all avenues will be explored before making any final recommendations.

Gentlemen, this seems to be a rather heavy letter, but it was really a treat to me to see the mill working (it produced approximately 30,000 bd. ft. Saturday while I was there), and I do not retreat from any of my convictions that your mill will truly be one of the best in this state within just a few weeks.

I will keep you appropriately informed.

Respectfully yours,

TIMBER WEST, INC.

/s/ Jack P. Branch  
JACK P. BRANCH  
President

JPB:jmk

5:30 P.M.

Just talked to Phil Cook; he got just over 40,000 bd. ft. out today from the Helle mill.

330

HALE AND DORR  
ORIGINAL FILE COPY  
Not To Leave The Office

December 13, 1977

Dear Phil:

Just a note to tell you how much Mr. Bolten and I appreciate all you are doing for us at Landreth. You are obviously doing an outstanding job and we truly appreciate it.

Please extend Mr. Bolten's and my thanks to the other people in the organization who I know are working so hard to get this operation "on the road."

We wish you and yours a very happy Christmas and prosperous and healthy 1978.

Most sincerely,

S. S. DENNIS 3D

Mr. Philip Cook  
Landreth Timber Co., Inc.  
Tonasket, Washington 98855

331

HALE AND DORR  
ORIGINAL FILE COPY  
Not To Leave The Office

December 16, 1977

Mr. John Bolten  
165 Via Bellaria  
Palm Beach, Florida 33480

Dear John:

I am enclosing a copy of a letter regarding additional funding at the Mill which I believe is self-explanatory.

Phil Cook is progressing so fast, the additional money which we had scheduled is being required sooner than planned. However, the Mill is going to be so much more productive and profitable than our original cash flow analysis that Phil thinks we will be paying off bank loans before the middle of the year in spite of having to put about \$100,000 which was not anticipated into new equipment (edger and planer).

Sincerely,

S. S. DENNIS 3D

## TIMBER WEST, INC.

December 19, 1977

Mr. Samuel S. Dennis 3rd  
Mr. John Bolton  
Hale & Dorr  
Counselors at Law  
60 State Street  
Boston, Massachusetts

Re: Landreth Timber Mill

Dear Sam & John:

Phil Cook came over this week-end to review the debarker purchase and meet with the people on the new debarker. From all indications, we have made a very good purchase. The total price being \$25,000 and the indications of approximately \$10,000 of installation labor. The terms were worked out at \$5,000 on delivery, approximately the end of this week, and the balance in January (end of January) from production profits.

We are getting all of the setting plans and the total infeed decking including the engineering plans that would have cost at least \$10,000 (engineering alone). Additionally, there is at least \$15,000 in spare parts (extra ring, extra teeth, extra spare motor and miscellaneous spare parts).

I discussed this with Phil and will at a later date discuss it with Peter and it is my opinion we can capitalize at least \$10,000 extra dollars of our regular mill labor to suffice for this engineering. In other words, we would take a small portion of the labor cost from our Helle production and define the remainder as installation cost and capitalize it. I will discuss this with Peter and inform you appropriately.

Phil has done an excellent job in finding a real bargain and got prices and terms suitable to his cash flow and in my opinion he proved another of the many assets he has by being astute in trading as well as aware of our cash flow involved in securing liveable terms.

I will keep you informed.

Respectfully yours,

TIMBER WEST, INC.

/s/ Jack P. Branch  
JACK P. BRANCH  
President

JPB:jmk



## TIMBER WEST, INC.

December 19, 1977

Mr. Phil Cook  
General Manager  
Landreth Timber Company  
Tonasket, WA 98855

Re: Discount policies lumber sales

Dear Phil:

Just a note to summarize our conversation concerning discount policies with reference to lumber sales. Also taking in mind Mr. Dennis' letter of December 7, 1977 concerning this matter.

Phil, I totally concur with Sam on the overall policy of adhering (sic) as close as possible to the full price theory of sales and where I do not find any particular fault with the method you have used in handling sales to this date, I would like to go on record as saying that we definitely do not wish to fall into a rut of discounting and especially at the figure of 5%.

Phil, I realize that there will be emergencies or unique situations where quality is not up or as in the incidence this past two weeks where sufficient cash was not in the bank for payroll and the added expenses. These items are to the exceptions and certainly not the rule and as per our general conversation along these lines and your ensuing conversation with Mr. Sam Dennis, I am certain you understand our overall feeling in regard to pricing sales and discounts.

I feel you have done an excellent job under a great deal of duress and I do not wish this letter to be construed in a critical manner. Please keep up the good work and

let me hear from you should you have any problems out of the ordinary.

Sincerely yours,

TIMBER WEST, INC.

JACK P. BRANCH  
President

JPB:jmk  
cc: Sam Dennis  
John Bolton

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

---

Civil Action No. C78-663R

LANDRETH TIMBER COMPANY, INC.,

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR. and KATHLEEN LANDRETH, husband and wife,  
*Defendants.*

---

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR. and KATHLEEN LANDRETH, husband and wife,  
*Counterclaim Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim Defendant.*

---

AMENDED NOTICE OF APPEAL

NOTICE IS HEREBY GIVEN that Landreth Timber Company, plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Judgment entered in this action on May 27, 1981.

DATED this 28th day of May, 1981.

EDWARDS & BARIBERI

By: /s/ John W. Hathaway  
JOHN W. HATHAWAY

Attorneys for Plaintiff

EDWARDS & BARBIERI  
3701 Bank of California  
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(206) 624-0974

Counsel for Defendants/Respondents  
Ivan K. Landreth, et al., is:

James A. Smith, Jr.,  
BOGLE & GATES  
Bank of California Center  
Seattle, WA 98164

H/7291B

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON

---

Civil Action No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, *et al.*,  
*Defendants.*

---

IVAN K. LANDRETH and LUCILLE LANDRETH,  
husband and wife, *et al.*,  
*Counterclaim Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim Defendants.*

---

**ORDER OF DISMISSAL**

THIS COURT, on February 29, 1981, entered an Order Granting Summary Judgment in favor of defendants on the basis that the transaction at issue did not involve a sale of securities within the purview of the federal securities laws. Judgment was entered on May 27, 1981. Having concluded that there is no federal jurisdiction over plaintiff's pendent claims or defendants' counterclaims it is now, therefore,

ORDERED that all claims raised by plaintiff and defendants in the above-captioned action are dismissed for lack of federal jurisdiction.

DONE IN OPEN COURT this 13 day of July, 1981.

---

BARBARA J. ROTHSTEIN  
Judge

Presented by:

BOGLE & GATES

/s/ Guy P. Michelson  
JAMES A. SMITH, JR.  
GUY P. MICHELSON  
PATRICIA H. CHAR  
RICHARD D. VOGT  
Attorneys for Defendants

Copy Received; Approved as to  
Form and Notice of Presentation  
Waived:

EDWARDS & BARBIERI

/s/ Charles K. Wiggins  
CHARLES K. WIGGINS  
Attorneys for Plaintiff



IN THE UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

---

Case No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
Plaintiff,

vs.

IVAN K. LANDRETH, *et al.*,  
Defendants.

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COURT'S ORAL RULING

Transcript of proceedings in the above-entitled and -numbered cause, before the Honorable Barbara J. Rothstein, United States District Court Judge, on April 17, 1981.

THE COURT: Counsel, by way of preface to the court's remarks, let me indicate I have read the briefs in this matter and given it very careful consideration. I do not expect my remarks today to be all inclusive by any means. I am going to try to get you a more detailed written statement actually on both issues, probably on the original ruling and this one. I think it will help counsel if there is going to be an appeal to clarify what the court's reasoning was.

For purposes of simplicity I should indicate the court's remarks are going to be primarily addressed to the third portion of the Howey test and that is the reasonable expectation of profits or another way of putting that is the success of the business and that this success will be dependent upon the efforts of others.

The court believes that if indeed the plaintiffs have failed to meet that test then actually the question of the

pooling or commonality test is not really something the court needs to reach. The control test is determinative as far as the court is concerned.

The court believes that the factors that the court should consider are the factors that were present at the time the agreements between the parties were reached and those agreements should be the final agreements of the parties, whether they were reached exactly on November 17th or a few days before that or whatever; the agreements the parties actually executed in the purchase and sale of the business. The court does not believe that earlier factors should be considered; that, I feel, would represent a duplication of allegations of misrepresentation and fraud.

Without going into all of the facts again as set forth by the defendants, it is clear to the court that at the time of closing the plaintiffs intended to keep Landreth on in a consulting capacity. The consulting capacity and the capacity set forth in the consultant agreement was clearly that of an advisor only.

Plaintiffs took all steps necessary to assure that the actual control of the enterprise was in the hands of their own manager. Prior to closing they hired that manager and from everything the court could see very carefully interviewed to hire a manager; that they intended to have complete managerial control of the enterprise. They took additional steps in that they got resignations from all officers and directors, and in short the court is convinced the intent was to have all of the managerial functions in the hands of their own person.

The fact that plaintiffs were absentees, the fact that they themselves had—and the court is convinced they had—no experience in this area is really immaterial, because the term "efforts of others", the term "others" in that phrase doesn't mean anyone other than persons like the plaintiffs who actually are the owners. The owners,

of course, can proceed to run a business through persons they hire, and that, as far as the court is concerned, is not placing it under the control of others. The "other" that would have to be shown here would be that it was Landreth himself, at least on this fact situation. And the fact that the plaintiffs themselves personally did not enter into the running of the business, nor had they any intention of doing so is really not the issue and the court is not persuaded by that.

The court will just make one other comment in that I think the use of the term "reasonable expectation" implies that the test the court must apply is that of an objective test. The court must look to the facts that are available and were available to the parties at the time, and it again must be an objective test. The fact that now at this stage of the game an individual comes back and said that there was some intent at the time not to go through with a deal unless Mr. Landreth were in some way to do something that is just not consistent with the contract entered into by the parties, is not the type of evidence I believe the court should be concerned with in determining the understanding of the parties at this time.

I, therefore, think the court's ruling would be to find that there is a lack of a federal question here and the case would have to be dismissed on that ground.

Again, I will try to get you a better set of reasons, because I do think that the cases cited and the more detailed statement of facts involved would be helpful to you, but I thought rather than keep this thing going on any longer, I would give you the court's reasoning as soon as I was aware of it, and I felt I was aware of it after argument today.

Again, we will try to get that to you as soon as possible.

Is there something else, counsel?

MR. SMITH: Yes, your honor. I noticed in reviewing the El Khadem case in preparation for argument that in that case the court said that because a question had been raised as to whether or not this was a transaction in securities that it technically was not a dismissal for lack of a federal question, but was properly a dismissal for failure to state a claim. I don't know if that in any way bears on the form of the court's decision, but I wanted to point out that decision does contain by way of footnote that reference.

THE COURT: I will take a look at that. My initial response was that I didn't intend to be stating in any way any kind of a ruling, and I should make this clear, on the merits of any of the other claims that plaintiffs' are bringing up. In other words, they have a host of other claims that do not rise under federal statutes, and perhaps the better way to word it would be to say failure to state a claim, but to make that very clear in the court's decision. The reason the court was choosing the other way was to make it clear that it was only the securities question the court has been called to rule upon. I have made no assessment at all as to the veracity of any alleged misrepresentations or fraud or whatever, and I just want that to be very clear to the parties. I suppose I can make that clear whatever way I dismiss.

Did you have a comment on that, Mr. Edwards?

MR. EDWARDS. I had a question just to find out whether I understand the court's ruling. Did the court mean to indicate factors which may have induced the formation of a contract are not relevant, you only look at the contract itself in determining whether or not there is an investment security, particularly the control element? Is that what the court meant when the court said that if they were induced into entering into a contract by a representation that Mr. Landreth would stay on, that this was immaterial?



THE COURT: Let's put it this way, Mr. Edwards. As the court understands it, your allegation or your clients' point is that at some point in the negotiations they may have been very interested in having Mr. Landreth stay on and indeed may even have approached him to stay on in a full-time managerial capacity. That is not the way it ended up. The fact that they may have originally gotten into the negotiations and may have originally gotten involved because they thought he would stay on or he told them he was going to stay on, the fact is that by the time they closed they knew that he was only going to be on as a consultant and they still went through with the closing. Those are the factors that the court thinks are relevant, what happened at the time. If somewhere along the line they thought he was coming in but then he said, "I don't want to be involved full time," they went ahead and closed, understanding that he was going to be only in a consulting capacity, that's all the court is going to look at.

MR. EDWARDS: I would only suggest that the court look at the affidavit of Mr. Dennis again, because I don't think that's what it says.

THE COURT: I understand. Court will be in recess.

#### CERTIFICATE

I, Joseph F. Roth, the undersigned, an official court reporter for the United States District Court, do hereby certify that the foregoing transcript of proceedings is a true, complete and accurate report of my stenograph notes, to the best of my ability.

JOSEPH F. ROTH

#### UNITED STATES DISTRICT COURT WESTERN DISTRICT OF WASHINGTON

Civil Action No. C78-663R

LANDRETH TIMBER COMPANY, INC.  
*Plaintiff,*

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR. and KATHLEEN LANDRETH, husband and wife,  
*Defendants.*

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR. and KATHLEEN LANDRETH, husband and wife,  
*Counterclaim Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim Defendant.*

[Filed July 20, 1981]

#### NOTICE OF APPEAL

NOTICE IS HEREBY GIVEN that Landreth Timber Company, plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Order of Dismissal entered in this action on July 13, 1981.



DATED this 20th day of July, 1981.

EDWARDS & BARBIERI

By /s/ Charles K. Wiggins  
CHARLES K. WIGGINS  
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H/8642B

(H)  
No. 83-1961

Office - Supreme Court, U.S.  
**FILED**

**JAN 11 1985**

ALEXANDER L. STEVENS,  
CLERK

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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1984

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LANDRETH TIMBER COMPANY,  
*Petitioner,*

v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
AND KATHLEEN LANDRETH,  
*Respondents.*

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On Writ of Certiorari to the  
United States Court of Appeals  
for the Ninth Circuit

---

**BRIEF OF PETITIONER**

---

JAMES L. QUARLES III  
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and

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HALE AND DORR  
60 State Street  
Boston, Massachusetts 02109  
(617) 742-9100

## **QUESTION PRESENTED**

Whether the purchasers of all the common stock of a conventional business corporation acquired "securities" within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934, entitling them to the protections afforded by those statutes.



## PARTIES INVOLVED

The petitioner is Landreth Timber Company, a corporation organized under the laws of the State of Delaware. The Class A shares of Landreth Timber Company, representing 85% of the equity of the corporation, are owned by Samuel S. Dennis, Esq. and the estate of John Bolten. The Class B shares, representing the remaining 15% of the equity, were held by Mr. Jack Branch, Mr. and Mrs. Al Willard, Mr. Troy N. Beaver, Mr. Troy N. Beaver, Jr., and Mr. Robert E. Branch at the time the action was commenced.

The respondents are Ivan K. Landreth, Lucille Landreth, Thomas E. Landreth, Ivan K. Landreth, Jr. and Kathleen Landreth.

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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1984

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No. 83-1961

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LANDRETH TIMBER COMPANY,  
*Petitioner,*  
v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
AND KATHLEEN LANDRETH,  
*Respondents.*

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On Writ of Certiorari to the  
United States Court of Appeals  
for the Ninth Circuit

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BRIEF OF PETITIONER

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit was issued on March 7, 1984, and is reproduced in the Appendix to the Petition for Certiorari ("Pet. A.") at 1a-10a. One paragraph of that opinion was modified by an order dated April 24, 1984.<sup>1</sup> Pet. A. 11a-

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<sup>1</sup> The April 24, 1984 Order, deleted the paragraph at page 2-3 of the original opinion, which had read:

For a variety of reasons, Landreth II was unprofitable. Landreth underestimated the cost of rebuilding the mill. Much

12a. The opinion, as modified, is reported at 731 F.2d 1348. The unreported order and judgment of the United States District Court for the Western District of Washington is reproduced at Pet. A. 12a-21a.

### JURISDICTION

Jurisdiction to review the judgment of the United States Court of Appeals by writ of *certiorari* exists pursuant to 28 U.S.C. § 1254(1).

### STATUTES INVOLVED

The statutes principally involved in the opinion and order of the Court of Appeals, and to be construed here, are the definitional sections of the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* The relevant portions of the definitional sections of those Acts, 15 U.S.C. §§ 77b (1) and 78c(a) (10) are reproduced at Pet. A. 22a-23a.

### STATEMENT OF THE CASE

Because the Court of Appeals was reviewing the grant of the respondents' motion for summary judgment, it was obligated to view the facts in the light most favorable to the petitioner, resolve all disputed facts in the petitioner's favor, and afford the petitioner all favorable inferences arising from those facts. *SEC v. Murphy*, 626 F.2d 633, 640 (9th Cir. 1980). Viewed from that perspective, the record before the Court of Appeals revealed the following facts.

of the machinery Landreth had warranted was operable was not. Appellant completed the rebuilding and replaced the inoperable machinery, but the productive capacity of the completed mill was considerably below Landreth's prediction. Unable to operate the mill profitably, Landreth II sold the mill and went into receivership.

The Order added the following to the next paragraph:

Landreth II was unprofitable. It sold the mill, and went into receivership.

In 1976 Ivan K. Landreth and his two sons,<sup>2</sup> the shareholders of Landreth Timber Company ("Landreth Timber") located in Tonasket, Washington, offered their stock for sale through both Washington and out-of-state brokers.<sup>3</sup> R. 93, 11-14, 157, 158; R. 123, 2; R. 69, 277. Ivan K. Landreth had operated Landreth Timber since 1954. R. 69, 222. In May 1977, before a purchaser could be found, Landreth Timber's sawmill was extensively damaged by fire. R. 69, 224. Despite the fire, the Landreths' brokers continued to attempt a sale, reporting that the inoperable mill would be rebuilt and a computerized component added which would increase substantially the sawmill's productivity when it was rebuilt. R. 69, 233; R. 93, 44.

Relying upon information provided by Mr. Landreth to his local broker, R. 93, 51, 54, 56, 66-83, 87, one broker offered Landreth Timber by means of a letter. J.A. 97. The letter contained representations of the type traditionally contained in offering memoranda, prospectuses, or other vehicles used to sell stock. It represented that the burned mill would be reconstructed and modernized from the insurance proceeds, the number of board feet of lumber the reconstructed mill would extract from logs,<sup>4</sup> the

<sup>2</sup> Ivan K. Landreth, Jr. and Thomas E. Landreth. Also named as defendants were the wives of Mr. Landreth and his son Ivan K. Landreth, Jr., because the proceeds of the sale of their shares inured to the benefit of the marital community of each of these men and their wives.

<sup>3</sup> Citations to the record from the District Court for the Western District of Washington, as certified by the Clerk of the Court of Appeals for the Ninth Circuit, appear as ("R. —, —"). The title of and an identifying reference to each cited document is contained in Appendix A to this Brief.

<sup>4</sup> Logs are measured by a "scribner scale" which predicts the number of board feet of lumber they will produce. The reconstructed mill was represented to produce double the amount predicted by the scribner scale so that logs scaled to produce 100,000 board feet would produce 200,000 board feet. J.A. 98-99.



existing contracts,<sup>6</sup> the number of board feet the mill could produce per shift when reconstructed,<sup>6</sup> the ability of the reconstructed mill to operate two shifts per day, and the profits to be expected. J.A. 97-100.

The representations in the letter were false. Mr. Landreth had underestimated the cost of rebuilding the mill according to his plans. It could not be reconstructed from the insurance proceeds. J.A. 91-92. The mill, when reconstructed according to Mr. Landreth's plans, would not be capable of extracting the represented number of board feet from logs. J.A. 92-93. The existing chip contract referred to in the letter had been terminated because the mill could not produce commercially usable chips. R. 108, 76-77; R. 114, 3-5. The reconstructed mill would be incapable of producing the represented production per shift. J.A. 92-93.

Nonetheless, when the letter reached Mr. Samuel Dennis through a Massachusetts broker it had its intended effect. J.A. 81-82, 96. Mr. Dennis was then a 67 year old tax attorney who practiced in Boston, but lived in Florida during parts of the winter. J.A. 80-81. The letter interested him in Landreth Timber as an investment. J.A. 81. He contacted the late John Bolten, then an 84 year old friend and client who had retired to Florida, and informed him of the offer. J.A. 82-83, 95. Mr. Bolten, too, was interested. However, located a continent away, having no prior experience in the timber industry, J.A. 81, 346; Pet. A. 14a, and at an age when retirement income was more relevant than radical career changes, neither Mr. Bolten nor Mr. Dennis contemplated relocating to Washington to operate Landreth Timber. J.A. 81, 87-88; R. 148, 4-5.

<sup>6</sup> The letter referred to a chip contract with Weyerhaeuser Corporation. J.A. 98. In fact, the contract had been with International Paper Company. R. 108, 76-77; R. 114, 3-5.

<sup>6</sup> The mill was represented to be capable of easily producing 200,000 board feet per two-shift day when reconstructed. J.A. 99.

Mr. Dennis contacted the broker who had written the letter. The broker confirmed the statements in the letter. J.A. 82. When Mr. Dennis asked that the business be evaluated, the broker retained an accountant who had no knowledge or experience in the lumber business, had no clients in the sawmill business and never had investigated the purchase of a company whose physical plant was under construction. J.A. 84; R. 137, 2; R. 69, 321; R. 93, 129. An engineering firm also was retained to inspect the inoperable mill. J.A. 86. Because the mill had operated only sporadically for many years, J.A. 109, and the company's internal management control was too weak to permit a preacquisition audit, R. 137, 4-5; R. 93, 131, the accountant and the engineering firm relied substantially upon information provided by Mr. Landreth. R. 137, 2, 4-5, 5-6.

The accountant visited Mr. Landreth at Landreth Timber. Mr. Landreth represented the lumber production costs, amount of finished lumber and receipts which could be expected, that the mill would be operational by November 1, 1977, and could produce more than half its output as a highly profitable, fine quality lumber.<sup>7</sup> R. 137, 2-5; J.A. 84-85. Those representations were passed on to Mr. Dennis. J.A. 84-85.

Mr. Dennis visited Tonasket only once prior to the acquisition. J.A. 86. Mr. Landreth assured Mr. Dennis that the represented productive capacity could be achieved and that the non-burned facilities were in good condition and suitable for use. J.A. 86-87. Indeed, Mr. Landreth had earlier represented that his accountant had valued his business at five to six million dollars. J.A. 83;

<sup>7</sup> Mr. Landreth informed the accountant that the reconstructed mill "conservatively" could produce 52% of its output as the highly profitable "lamstock." Lamstock is a finely grained form of lumber produced under precise conditions and used in the laminating industry. In fact, the mill was incapable of achieving the required precision and could produce only low grade lumber. R. 137, 3-4.

R. 93, 158. In fact, no appraisal has been made, and Mr. Landreth had arrived at the numbers himself. R. 93, 15-16.

Because neither Mr. Dennis nor Mr. Bolten had the intent or ability to manage a corporation engaged in the timber business or the operation of a sawmill, they were concerned about the continuity and competency of Landreth Timber management should they purchase the company's stock. Pet. A. 14a; J.A. 87-88. Accordingly, Mr. Dennis asked Mr. Landreth to remain as general manager of the sawmill and to become a member of the board of directors of the new corporation. J.A. 87-88. Having previously cited personal health problems as the reason for the sale, R. 93, 158, Mr. Landreth declined both positions. J.A. 87-88. Instead, he agreed to assist in the company's management as a paid consultant when Mr. Dennis made the offer to purchase Landreth Timber stock contingent upon Mr. Landreth's continued involvement in the day-to-day operations of the sawmill. J.A. 87-88. He ultimately signed a consulting contract in which he acknowledged that his services were "unique and extraordinary," of "peculiar" value, and agreed:

(a) to participate in the operation of the timber mill owned by the Company for the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period.

J.A. 159.

Motivated by the favorable treatment federal tax law provides to a seller of stock, the assumption of all liabilities by the purchasers, and the difficulty in assigning Forest Service contracts, Landreth required from the outset that the purchasers acquire the shares of Landreth Timber. J.A. 83; R. 123, 2. Negotiations resulted in a stock purchase agreement, with Mr. Dennis the purchaser, and Mr. Landreth and his sons the sellers of Landreth

Timber's common stock. J.A. 164. As the stock purchase agreement specifically contemplated, Mr. Dennis assigned his rights to a Delaware corporation, B & D Company<sup>\*</sup> which had been formed for the sole purpose of acquiring Landreth Timber's common stock. J.A. 164, 165. After B & D Company became the owner of Landreth Timber's stock, it merged with Landreth Timber. The result was a Delaware corporation bearing the name of the original corporation, Landreth Timber Company. Messrs. Dennis and Bolten owned the Class A stock representing 85% of the equity. Six other persons, none of whom intended to become actively involved in Landreth Timber's operations, J.A. 87, owned the Class B shares representing the remaining 15% of the equity. J.A. 89.

After the acquisition was completed, the disparity between Mr. Landreth's representations and reality became apparent. The mill was not operating at the time of the acquisition. The actual post-acquisition cost of rebuilding the sawmill exceeded Mr. Landreth's figures by more than \$500,000. J.A. 91-92, 270-74. Even then the sawmill never became fully operational. Mr. Landreth's representation that construction of the computerized portion of the mill would be completed within two weeks of the closing at a labor cost of \$5,000 was shattered when approximately ten weeks and almost \$90,000 were required. J.A. 91. Additionally, Landreth Timber's liability to the manufacturer of the computerized portion of the mill for materials exceeded Mr. Landreth's representations by approximately \$80,000. J.A. 91. Moreover, almost \$235,000 was expended after the closing for labor and equipment to complete construction of the non-computerized portion of the sawmill, an expenditure Mr. Landreth did not disclose was required. J.A. 92.

When the computerized mill was first tested in February 1978, existing components of the sawmill were dis-

<sup>\*</sup> The corporation was named B & D Company after Messrs. Bolten and Dennis.



covered to be incompatible with reconstructed portions, or to be defective and incapable of running for even a single shift, much less the two shifts warranted by Mr. Landreth. J.A. 87. Accordingly, major pieces of existing equipment had to be replaced at a cost of approximately \$80,000. J.A. 91, 92.

Mr. Landreth's representation that the equipment was in good operating condition and capable of producing 200,000 board feet per day, J.A. 87, 89, 210-11, proved false. In fact, before the fire Mr. Landreth had operated the mill only sporadically. J.A. 109. He had not operated it for two shifts per day for a number of years and never had done so on a regular basis. R. 93, 5. Even after the inoperable machinery was replaced, the sawmill continued to experience abnormal problems due to the poor operating condition of the remaining used machinery. J.A. 91-92; R. 108, 103-04, 106-09, 111. It was incapable of producing the high grade lumber represented, or even a fraction of the represented quantity per shift. J.A. 92-93.

Although a new general manager was hired after Mr. Landreth signed the consulting agreement, Mr. Landreth remained active in the management of Landreth Timber's operations.<sup>9</sup> Indeed, he informed the employees that he still owned the business and that Messrs. Bolten and Dennis only had contributed additional financing to complete reconstruction. R. 148, 2-4. Mr. Landreth continued to confer in and implement decisions for Landreth Timber concerning reconstruction of the sawmill and expenditures for equipment acquisitions and maintenance. R. 108, 41-43, 46, 58, 131-32. He also participated in the

<sup>9</sup> Apart from the hiring of a general manager to replace Mr. Landreth, the company's key personnel remained the same. After the 1977 fire Mr. Landreth had kept his key personnel, including his plant manager who had been with him for many years. These people, he assured the investing group, were competent, experienced and could satisfactorily run the new operation on a two-shift basis. J.A. 87; R. 148, 4-5.

bidding for, and acquisition of, timber contracts. R. 108, 46. When confronted by the extent to which the actual cost of reconstructing the mill exceeded his representations, he responded "I sold stock. I didn't sell anything else." R. 108, 91. Mr. Landreth's consulting contract was terminated in January when the extent and materiality of his misrepresentations became known. J.A. 90-91; R. 148, 4.

After the closing, Messrs. Bolten and Dennis' involvement in Landreth Timber was to advance additional funds in an attempt to complete the reconstruction of the mill. J.A. 93; R. 148, 2. When it became apparent that the company could not finance the construction overruns and operating deficits resulting from Mr. Landreth's failure to disclose the true state of reconstruction, and from the remaining capital expenditures and defects in the equipment, the general manager apprised the shareholders of the cost overruns, the worsening financial situation and requested their financial assistance. R. 148, 2; R. 108, 81-82. Because Messrs. Dennis and Bolten personally advanced over \$635,000 and guaranteed approximately \$2 million in new bank loans, they requested that the general manager consult with them concerning the expenditure of those funds. J.A. 93; R. 148, 2.

By July 1978 the shareholders could no longer continue to pay for the losses and cash-flow deficits. J.A. 93-94. Incapable of profitable operation, the sawmill was transferred to the Tonasket Timber Company and Landreth Timber Company closed its doors. J.A. 94. The sawmill eventually was foreclosed upon at a sheriff's sale. J.A. 94.

Landreth Timber Company sued within one year of the stock transaction, seeking damages of \$2,500,000 for violations of the federal securities laws.<sup>10</sup> Specifically,

<sup>10</sup> The common stock of the original Landreth Timber had been acquired for \$3,953,095. In its complaint, as amended, petitioner alleged violations of Sections 12(1), 12(2) and 17(a) of the Secu-



Landreth Timber alleged that it was entitled to rescind its purchase because the respondents had widely offered and then sold the shares without registration, in violation of the Securities Act of 1933, and negligently or intentionally had made misrepresentations, or omitted to state material facts. J.A. 23-36, 37-50.

After more than two years of discovery, the filing of notices of 37 depositions, production of voluminous documents, responses to interrogatories and requests for admission, J.A. 1-7, the Landreths moved for summary judgment asserting that, because the petitioner had purchased 100 percent of the stock of Landreth Timber, it had not purchased a "security." J.A. 78; R. 68, 11-12. The petitioner cross-moved for summary judgment asserting that the Landreths had violated the provisions of §§ 5 and 12(1) of the 1933 Act, 15 U.S.C. §§ 77e and 77l(1), by failing to register the security they had offered widely for sale. R. 115, 1.

The District Court granted the respondents' motion, Pet. A. 12a-13a, and dismissed for lack of federal question jurisdiction. J.A. 343. Although the court found that the common stock purchased "possessed the ordinary characteristics of stock," Pet. A. 13a, it held that the common stock was not a "security." Applying the test to define an "investment contract" developed in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), the court held that the sale of Landreth Timber did not qualify as an "investment contract." Pet. A. 19a.

The United States Court of Appeals for the Ninth Circuit affirmed. Recognizing that "[w]hether sale of 100 percent of the stock of a closely-held corporation is a transaction involving a 'security' has divided the cir-

curities Act of 1933, 15 U.S.C. §§ 77l(1) and (2) and 77q(a) and Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b). Landreth Timber also raised pendent claims under the laws of the State of Washington. The District Court dismissed those claims for lack of jurisdiction after it dismissed the federal securities law claims to which they were appended.

cuits and commentators," Pet. A. 5a (footnote omitted), and was a question of first impression in the Ninth Circuit, Pet. A. 6a, the court held that the stock was not a "security." Pet. A. 8a-9a. The court concluded that earlier decisions in which it had adopted the so-called "risk capital test" to determine whether a note was a "security," required that it focus on the transaction rather than the instrument. Pet. A. 6a-7a. Applying its analysis, the court concluded that because the transaction was a "sale-of-business" rather than "a contribution of risk capital subject to the entrepreneurial or managerial efforts of others," the federal securities laws were inapplicable. Pet. A. 7a.

#### SUMMARY OF ARGUMENT

The appropriate starting point for determining whether shares of stock in a conventional business corporation are "securities" within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934 is the plain language of the definitional sections of those Acts. *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558 (1979). Their plain language specifically includes "stock," and the common stock at issue here, as the courts below found, possessed all of the characteristics this Court has held to be ordinarily associated with stock. See, e.g., *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851 (1985). Accordingly, there is no warrant for excluding these shares of ordinary common stock from the coverage of the federal securities laws.

The Court of Appeals' ruling that the common stock of Landreth Timber was not a "security" because one hundred percent of the shares were exchanged cannot be justified by any variant of the so-called "sale of business doctrine." That doctrine depends largely upon construing the "unless the context otherwise requires" clause, preceding the definitional sections of the federal securities laws, to permit courts to examine the *factual* "context" of

individual transactions, as opposed to the *statutory* context, to determine whether the federal securities laws apply to even the most common and typical instruments. That construction of the clause is wrong because it contradicts the plain meaning of the words of the clause, produces illogical results when applied to the other definitional sections it precedes, is inconsistent with the legislative history of the clause, and attributes a meaning to the clause different from its meaning in the numerous other federal statutes containing that clause.

Exempting this transaction from the federal securities laws, as the courts below did, also is inconsistent with the carefully crafted structure of the federal securities laws. When, for example, Congress intended to exempt a transaction from some aspect of the securities laws it did so explicitly, but left the transaction and the securities involved in it subject to other provisions of the 1933 and 1934 Acts. The judicially created "sale of business" exemption, however, abandons that precise approach and exempts a type of transaction from all of the Acts' requirements without so much as mentioning the transaction, much less attempting to define it.

The Ninth Circuit and other courts adopting the "doctrine" have misread this Court's decisions. This Court consistently has applied a two-part test to determine whether an instrument is a "security." Recognizing that settled canons of construction require that the specifically named, typical instruments such as "stock" have a meaning separate from the definition created for the atypical instrument known as an "investment contract," this Court first has examined the instrument to see whether it has the characteristics traditionally associated with its name. *Forman*, 421 U.S. at 848-51. Only when an instrument neither claims to be, nor actually is, one of the instruments specifically enumerated in the 1933 and 1934 Acts has the Court applied the test developed in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943), and

*SEC v. W.J. Howey Co.*, 328 U.S. 293 (1948), for determining whether an instrument is an investment contract.

Finally, adopting the "sale of business doctrine" as a test upon which federal jurisdiction depends is unwise. Jurisdiction should be determined by precise statutory conditions, not wide ranging inquiries into extrinsic facts. *Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21 (1934). But determining whether "control" has been transferred, and to whom, is a complicated legal and factual inquiry. Moreover, the doctrine's reliance upon a supposed distinction between "entrepreneurs" and "investors" requires courts to make a distinction even the proponents of the doctrine recognize to be "fuzzy." *Sutter v. Groen*, 687 F.2d 197, 202 (7th Cir. 1982). The supposed distinction not only has no meaning, but its resolution requires an analysis of the subjective intent of the purchaser.

For these reasons, as more fully discussed below, the Ninth Circuit's judgment must be reversed.

## ARGUMENT

### I. THE PLAIN MEANING OF THE STATUTORY LANGUAGE OF THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934 REQUIRES THAT SHARES OF STOCK IN A CONVENTIONAL BUSINESS CORPORATION BE TREATED AS "SECURITIES" WITHIN THE MEANING OF THE FEDERAL SECURITIES LAWS.

"The starting point in every case involving construction of a statute is the language itself." *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558 (1979), quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, Jr., concurring).<sup>11</sup>

<sup>11</sup> See also *Chiarella v. United States*, 445 U.S. 222, 226 (1980); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 16 (1979); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979);



Just this term this Court reaffirmed that

only the most extraordinary showing of contrary intentions from [the statutory history] would justify a limitation on the "plain meaning" of the statutory language. When we find the terms of a statute unambiguous, judicial inquiry is complete "except in rare and exceptional circumstances."

*Garcia v. United States*, 53 U.S.L.W. 4016, 4017 (U.S. Dec. 10, 1984), quoting *TVA v. Hill*, 437 U.S. 152, 187 n.33 (1978), quoting *Crooks v. Harrelson*, 282 U.S. 55, 60 (1930). Those "rare and exceptional circumstances" exist only where the plain meaning produces an "absurdity" which is "so gross as to shock the general moral or common sense" and there is tangible evidence "to make plain the intent of Congress that the letter of the statute is not to prevail." *Crooks*, 282 U.S. at 60.

That some now desire that Congress had written a different statute cannot alter the statute Congress wrote, for a statute

"is not an empty vessel into which this Court is free to pour a vintage that we think better suits present day tastes." *United States v. Sisson*, 399 U.S. 267, 297 (1970). Considerations of this kind are for the Congress, not the courts.

*National Broiler Marketing Association v. United States*, 436 U.S. 816, 827 (1978). Here, the language of the statutes is clear and unequivocal and no "rare and exceptional" circumstances exist to justify ignoring the plain intent of Congress.

The definitional sections of the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* (1982) ("the 1933 Act"), and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* (1982) ("the 1934 Act"), both define a "security" to in-

*Sante Fe Industries, Inc. v. Green*, 430 U.S. 462, 472 (1977); *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 24 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976).

clude "stock."<sup>12</sup> 15 U.S.C. § 77b(1); 15 U.S.C. § 78c(a) (10). Similarly, Congress specifically included "stock" in its definition of a "security" in later enacted statutes regulating securities and securities transactions.<sup>13</sup> As the Fifth Circuit has noted, stock "represents to many people, both trained and untrained in business matters, the paradigm of a security." *Daily v. Morgan*, 701 F.2d 496, 500 (5th Cir. 1983). Stock is, as Professor Louis Loss has written, "so quintessentially a security as to foreclose further analysis." L. Loss, *Fundamentals of Securities Regulation* 212 (1983).

No one, least of all the courts below, has suggested that the shares of Landreth Timber stock sold by Mr. Landreth and his sons do not "on their face . . . answer to the name or description" of stock or do not have all of "the characteristics 'that in our commercial world fall within the ordinary concept of a security.'" *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851 (1975), quoting H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933). This Court has listed the "characteristics traditionally associated with stock." *Forman*, 421 U.S. at 851. "[T]he most common feature of stock [is] the right to receive 'dividends contingent upon an apportionment of profits,'" *id.*, quoting *Tcherepnin v. Knight*, 389 U.S. 332, 339 (1967), and "the other characteristics traditionally associated with stock" are the ability to negotiate, pledge or hypothecate the shares, the right to vote in proportion to ownership, and the prospect of appreciation in value. *Forman*, 421 U.S. at 851.

<sup>12</sup> Both sections define a "security" to include:

any note, stock, treasury stock, . . . preorganization certificate or subscription, transferable share . . . or, in general, any interest or instrument commonly known as a "security" . . .

<sup>13</sup> See Public Utilities Holding Company Act of 1935, 15 U.S.C. §§ 79 *et seq.* (1982) at § 79b(16); Investment Company Act 1940, 15 U.S.C. §§ 80a-1 *et seq.* (1982) at § 80a-2(36); and Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 *et seq.* (1982) at § 80b-2(18).



The shares of Landreth Timber had all of those characteristics and the district court correctly determined that they "possessed all the ordinary characteristics of stock."<sup>14</sup> Consequently, the plain meaning of the definitional sections of the federal securities laws commands that those shares are "securities."

**II. NEITHER THE PREFATORY "UNLESS THE CONTEXT OTHERWISE REQUIRES" CLAUSE NOR THE STRUCTURE, LEGISLATIVE HISTORY OR UNDERLYING POLICIES OF THE FEDERAL SECURITIES LAWS PERMITS ENGRAFTING THE "SALE OF BUSINESS DOCTRINE" ONTO THE PLAIN WORDS OF THE STATUTE.**

Those who seek to exclude typical, garden variety common stock from the definition of security have done so by adopting the "sale of business doctrine." *E.g.*, *Canfield v. Rapp & Sons, Inc.*, 654 F.2d 459, 465-66 (7th Cir. 1981). Courts adhering to the "doctrine" purport to find their justification in two places. First, they contend that the clause preceding each of the definitional sections—"When used in this chapter, *unless the context otherwise requires*"—grants to courts a roving commission to rewrite those definitional sections if the factual context, not the statutory context, moves them to do so. Second, they misread this Court's previous decisions to impose

<sup>14</sup> Pet. A. 13a. Because those shares had all the attributes of "stock," Mr. Landreth sought to obtain the favorable tax treatment provided by the Internal Revenue Code for sales of stock. *See, e.g.*, I.R.C. §§ 1245, 1250. Indeed, it was for this reason, among others, that the Landreths insisted that the transaction be effected by the sale of stock. Having obtained the benefits of treating the transaction as a sale of stock under one federal law, the Landreths now anomalously argue that the transaction should not be treated as a sale of stock for the purpose of another federal law. But nothing in the definitional sections of the Internal Revenue Code suggest any intent to employ a definition of "stock" or "security" different from the federal securities laws. *See* 25 U.S.C. §§ 7701(7), 3821(c)(1), and 1236(c).

the test formulated for the atypical instrument of an investment contract upon all securities. Neither justification withstands analysis.

**A. The Prefatory "Unless the Context Otherwise Requires" Clause Does Not Permit a Court To Rewrite the Plain Language of the Acts. Neither the Structure of the Definitional Sections, Their Legislative History, nor Congress' Use of That Clause in 43 Other Statutes Permits the Construction Some Courts Have Given That Clause.**

The first court of appeals to adopt the "sale of business doctrine" advanced the prefatory language appearing in 15 U.S.C. §§ 77b(1) and 78c(a)(10)—"When used in this subchapter, unless the context otherwise requires"—as a principal justification for exempting some transactions in common stock from the provisions of the 1933 and 1934 Acts. *Frederiksen v. Poloway*, 637 F.2d 1147, 1150 (7th Cir.), *cert. denied*, 451 U.S. 1017 (1981). In *Frederiksen* the court contended that Congress qualified the definition of "security" by the inclusion of this clause. It misread "context" to mean the factual circumstances surrounding a particular exchange instead of the "context" of the statute. Under this analysis, the federal securities laws do not apply to stock, that is a security in all other instances, if the "context" reveals that the sale of stock has effected a change in the control of the entity whose shares were transferred. That construction is contrary to the structure and legislative history of the definitional section of the Acts.<sup>15</sup>

<sup>15</sup> This Court first discussed the "unless the context otherwise requires" clause in *SEC v. National Securities, Inc.*, 393 U.S. 458 (1969). There, the Court noted that the prefatory clause represented a Congressional recognition "that the same words may take on a different coloration in different sections of the securities laws." *Id.* at 466. Respondents may argue that the reference to the clause in *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982), suggests a different meaning. But there the Court was addressing the question whether an instrument "not specifically excluded" from the definitions—a certificate of deposit in a federally regulated bank—

The "context" to which Congress referred in the prefatory clause was the "context" of the statute. No "sale of business" court has yet attempted to explain how its interpretation of the clause can be applied to the other 15 definitions in the 1933 Act and 40 definitions in the 1934 Act which the prefatory clause precedes. They have not explained the factual "context" or "economic realities" which might appropriately be examined to determine whether, for example, "[t]he term 'Commission' means the Securities and Exchange Commission," in 15 U.S.C. § 77b(5) or 15 U.S.C. § 78c(a)(15), or "the term 'State' means any State of the United States" in 15 U.S.C. § 78c(a)(16). Nor is it apparent why, for example, Congress would meticulously define the term "bank" in 15 U.S.C. § 78c(a)(6) if a court, guided by its then current view of the appropriate definition of a "bank" in the particular factual "context" it was analyzing, could hold that "a banking institution organized under the laws of the United States" was *not* a "bank".

If the 73d Congress had intended to grant the power to the courts to modify the Acts' statutory definitions as the "context" of the "economic realities" might suggest,<sup>18</sup> so unusual a legislative intent would, at a minimum, have been the focus of some comment in the legislative process. However, the legislative history of the clauses demonstrates that the Congress possessed no such unusual thought.

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was a security. The Court held that the nature of the instrument, and the substantial statutory scheme of regulation associated with it, made the certificate of deposit less like "ordinary shares of stock and 'the ordinary concept of a security,'" than instruments which were securities. *Id.* at 557. As in its earlier cases, the Court analyzed the nature of the instrument, not the transactional "context" in which it appeared.

<sup>18</sup> This is a doubtful proposition given the prevailing tensions at that time. See, e.g., *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

As introduced in both the House and the Senate, and as passed by the Senate, the 1933 Act contained the phrase "unless the *text* otherwise indicates" where the phrase "unless the *context* otherwise requires" now is found. H.R. 5480, 73d Cong., 1st Sess. 39 (1933) (emphasis added) (as enacted by the Senate on May 10, 1933); S. 875, 73d Cong., 1st Sess. 1 (1933). The final House version, however, was altered when the House Committee on Interstate and Foreign Commerce substituted, without comment, "unless the *context* otherwise requires" for "unless the *text* otherwise indicates." See H.R. 5480, 73d Cong., 1st Sess. (1933) (as enacted by the House on May 5, 1933) (emphasis supplied). The "context . . . requires" version ultimately was adopted by the House-Senate Conference Committee.

While the Conference Committee Report includes a discussion of the *significant* distinctions between the definitional subparts employed by the House and Senate, it omits *any* mention of the "text" to "context" shift. See H. Conf. Rep. No. 152, 73d Cong., 1st Sess. 24-29 (1933). If the House version sanctions the broad exemptive authority the proponents of the "sale of business doctrine" purport to find, while the Senate version does not, surely "the conferees . . . would at least have remarked upon so important a subject." *Ruefenacht v. O'Halloran*, 737 F.2d 320, 331 (3d Cir.), *cert. denied sub nom. Gould v. Ruefenacht*, 53 U.S.L.W. 3365 (U.S. Nov. 13, 1984). The Conferees' failure to remark signifies that both the "text" and the "context" to which the two legislative bodies "referred was obviously the context in which the defined words appear in the statute itself." *Id.* at 26.

Congress' failure to comment is readily understandable. Our research discloses no statute which uses the "unless the text otherwise indicates" language. On the other hand, the "unless the context otherwise requires" clause was a phrase Congress frequently had used before,



and repeatedly would use again. These precise words are contained in the definitional sections of at least 36 federal statutes.<sup>17</sup> Congress surely did not intend that the "context" of anything other than the statute be consulted to determine whether, in construing the Migratory Bird Conservation Act of 1929, 16 U.S.C. §§ 715 *et seq.* (1982), "the word 'take' shall be construed to mean pursue, hunt, shoot, capture, collect, kill, or attempt to pursue, hunt, shoot, capture, collect or kill," 16 U.S.C. § 715n, or to determine whether "the term 'Commission' means the Federal Communications Commission" in the Communications Satellite Act of 1962, 47 U.S.C. § 702(10) (1982). Yet the definitional section of each of those acts, and at least 34 others, contain the same "unless the context otherwise requires" clause found in the federal securities acts, and Congress presumably intended identical statutory language to have a consistent meaning. *Cannon v. University of Chicago*, 441 U.S. 677, 694-99 (1979). That requirement of a consistent meaning precludes an interpretation of the clause that authorizes a wide ranging inquiry into all of the economic and business circumstances surrounding the sale of an ordinary, typical share of stock.

**B. Neither the Structure of the Acts nor Their Legislative History Permits Engrafting the "Sale of Business Doctrine" upon the 1933 or 1934 Acts.**

Not only does the "sale of business doctrine" find no support in the "unless the context otherwise requires" clause, but imputing a broad exemptive authority to that clause offends the carefully crafted structure of the Acts. When Congress chose to exempt a specific instrument, or a specific transaction, from the full range of the securities laws, it did so explicitly and precisely.

<sup>17</sup> Because the number of currently effective statutory provisions which use these words is so great, they are listed in Appendix B to this Brief.

Each exemption Congress created from the securities laws has different, and carefully considered, consequences. The 1933 Act, for example, contains one section describing "exempted securities" and another describing "exempted transactions." 15 U.S.C. §§ 77c, 77d. "Exempted securities" include certain government securities, notes arising out of current transactions, and securities issued by banks, as well as securities issued in offerings under \$5,000,000 and exempted pursuant to regulations adopted by the SEC. But even as to those "exempted securities," Congress took pains to specify which of the provisions of the Securities Act would be applicable to these "exempted securities," and which would not. See 15 U.S.C. § 77q(c). Thus, although "exempted securities" are removed from the Act's registration requirements, the anti-fraud prohibition of Section 12(2) is applicable to them. Similarly, when Congress exempted certain *transactions* from the Act's registration requirements, 15 U.S.C. § 77d, it left those transactions (and the securities that figure in them) subject to all the Act's other provisions.

The "sale of business doctrine" imputes to Congress an intent to abandon this precise approach. The "doctrine" exempts a transaction from *all* of the Acts' requirements, without any reference to the transaction or the instrument in the Act, and provides no clue as to the manner in which an instrument which is the prototype of a security became a non-security.<sup>18</sup>

<sup>18</sup> Indeed, the "doctrine" is so lacking in precision that it seems inevitably to lead to the conclusion that the same shares of stock can be a "security" as to one party in a transaction, and not to another party in the same transaction. Cf. *Siebel v. Scott*, 725 F.2d 995 (5th Cir.), *cert. denied*, 52 U.S.L.W. 3891 (U.S. June 11, 1984). For example, a buyer owning a percentage of the stock insufficient to provide control (or 100% of the stock, whichever may be the test) may purchase sufficient shares to achieve control (or 100% ownership) from a single shareholder lacking control. The buyer has, therefore, acquired the "control" upon which the doctrine is predicated. Presumably, the "doctrine" would dictate that the buyer could not bring an action under the federal securities laws, because



When Congress desired to exempt a transaction from the 1933 and 1934 Acts it demonstrated no difficulty in doing so with precision.<sup>19</sup> Congress did not leave the task to judicial creativity. Congress' failure to include transactions involving sales of control among the transactions specifically made exempt further underscores the impropriety of judicially creating such an exemption.

Engrafting the "sale of business doctrine" upon the Acts does more than offend their pattern of exemptions. It threatens to repeal substantive provisions of the Acts. The Williams Act, incorporated into the 1934 Act, was designed to comprehensively regulate public tender offers. By its terms it is clearly intended to apply to a tender offer for all the common stock of a corporation, a transaction which would result in the transfer of control. But the Williams Act depends for its definitions on the definitional provisions of the 1934 Act, including the definition of "security." One of the principal provisions of the Williams Act makes it unlawful for any person to make a tender offer for "any equity security" registered under the Exchange Act without filing a disclosure statement with the SEC. 15 U.S.C. § 78m(d)(1) (emphasis sup-

the presence of control makes the stock not a "security." The "doctrine," however, would appear to dictate that the seller of the same stock sold a "security" and therefore enjoys the protection of the securities laws.

Nowhere in the definition of "security," or in the structure of either the 1933 or the 1934 Act, is there the slightest hint that Congress intended its definitional section to produce such variable and asymmetrical results. A definition characterizing the same instrument as one thing to one party and something else to another—in the same transaction—is a prescription for confusion, not a definition.

<sup>19</sup> In addition to the exemptions in the 1933 Act discussed above, the 1934 Act also includes a number of exemptions and authorizations to grant exemptions that relate to particular securities and particular transactions. See, e.g., §§ 3a(12), 12(g)(2), 13(d)(6), 14(d)(8) and 16(b), 15 U.S.C. §§ 78c(a)(12), 78l(g)(2), 78l(h), 78m(d)(6), 78n(d)(8) and 78p(d) (1982).

plied). Another provision defines a "person" for this purpose to be any "group" formed "for the purpose of acquiring, holding, or disposing of securities of an issuer." 15 U.S.C. § 78m(d)(3) (emphasis supplied). It is illogical to assume that Congress would have chosen to define "group," an important term of the statute, in terms of a "security" if it had thought that, in attaining "control," the group would not be (and perhaps never had been) purchasing "securities."<sup>20</sup>

The legislative history of the 1933 Act also demonstrates that the Ninth Circuit acted contrary to the intent of the Congress in exempting this transaction. On the occasion when Congress considered the sale of all the shares of stock in a corporation by a single (or small group of) shareholders, it clearly expressed its intent that the transaction be covered:

All the outstanding stock of a particular corporation may be owned by one individual or a select group of individuals. At some future date they may wish to dispose of their holdings and to make an offer of this stock to the public. Such a public offering may possess all the dangers attendant upon a new offering of securities.

H.R. Rep. No. 85, 73d Cong., 1st Sess. 13-14 (1933). In the face of that declaration, the judicial creation of an exemption for the sale of shares of a closely-held corporation "by one individual or select group of individuals" cannot be justified.

<sup>20</sup> Examples of the interpretive conundrums created by imposing this "doctrine" on statutes to which it has been a stranger for fifty years are limitless. If a 49 percent stockholder acquires one percent, has he purchased a "security"? What if he acquires two percent? If the owner of all the stock sells it to one buyer, the doctrine says he has not sold a "security." But suppose he sells it to several buyers? Has he engaged in a "securities" transaction if he sells "control" in a public offering?

**C. In Adopting the "Sale of Business Doctrine" the Court of Appeals Misinterpreted This Court's Decisions and Erred in Applying the "Investment Contract Test" as the Test Applicable to All Securities. The "Investment Contract Test" Is Applicable Only to Atypical Instruments, and Should Not Be Employed to Render the Same Instrument Both a Security and a Non-Security at the Same Time.**

For more than forty-five years after the 1933 Act was enacted, no court appears to have questioned the proposition that common stock of a conventional business corporation was a "security" in whatever transaction it appeared. This Court and others had recognized that the securities laws were designed to protect participants in private, as well as public, transactions. See, e.g., *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971); *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa. 1947).<sup>21</sup>

Indeed, when Landreth Timber's shares were sold, no published opinion of a court of appeals had declared that ordinary common stock was not a "security."<sup>22</sup> Subsequently, courts began to depart from the plain meaning of the statute by the adoption of the "sale of business doc-

<sup>21</sup> See also 3 L. Loss, *Securities Regulation* 1467 n.83 (2d ed. 1961) (collecting cases).

<sup>22</sup> This Court recognized in *Forman*, 421 U.S. at 850-51, that the name given to even an unusual instrument is not "wholly irrelevant" precisely because:

There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

trine," asserting that they were authorized to do so by decisions of this Court. They were not.

Ten years after the enactment of the 1933 Act, this Court held that the federal securities laws regulated the exchange of certain atypical instruments that, though not specifically enumerated in the Act's definitional section, nevertheless were within the meaning of the section's more generic phrases, such as "investment contract." *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 348-55 (1943). In *Joiner*, and every case which followed it, this Court first has looked at the instrument itself to determine whether the definition of a security has been met. Where the instrument is typical and bears the ordinary characteristics of such an instrument, the inquiry is complete. Where the instrument is atypical, this Court has examined the transaction by which the instrument was created, to determine whether the instrument was a "security." Significantly, this Court has never focused upon the transaction by which the instrument was exchanged after it was created to determine whether it is a "security" within the meaning of the federal securities laws.

While claiming fidelity to this Court's earlier decisions, the Ninth Circuit and other courts adopting the "sale of business doctrine" have employed a radically different analysis. As the "sale of business doctrine" is applied by those courts, the nature of the instrument becomes irrelevant, and shares having all the traditional aspects of stock become non-securities, not because of their nature when created or exchanged but because of the manner of their exchange. And, as the "sale of business doctrine" is applied by those courts, the test for a single type of instrument—"investment contracts"—becomes the test for all securities. That radical departure from this Court's prior decisions cannot be justified.



**1. The Two-Part Test Established by This Court for Determining Whether a Particular Instrument Is a Security Recognizes that Each Instrument Listed in the Definitional Sections of the Federal Securities Laws Has a Separate and Independent Meaning.**

In *Joiner*, the first case in which it interpreted the definitional sections, this Court recognized that the 1933 Act would be redundant, if not nonsensical, if it were read to require that an instrument uniformly recognized as "stock" must also be an "investment contract":

In the Securities Act the term "security" was defined to include by name or description many documents in which there is common trading for speculation or investment. Some, such as notes, bonds, and stocks, are pretty much standardized and the name alone carries well-settled meaning. Others are of more variable character and were necessarily designated by more descriptive terms, such as "transferable share," "investment contract," and "in general any interest or instrument commonly known as a security." We cannot read out of the statute these general descriptive designations merely because more specific ones have been used to reach some kinds of documents. Instruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description. However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contracts," or as "any interest or instrument commonly known as a 'security.'"

*Joiner*, 320 U.S. at 351. The Court also recognized that each of the investment instruments enumerated in the definitional section of the 1933 Act has a separate mean-

ing and significance and that the proof required to establish coverage of that Act varied with the type of instrument involved:

It would be necessary in any case for any kind of relief to prove that the documents being sold were securities under the Act. In some cases it might be done by proving the document itself, which on its face would be a note, a bond, or a share of stock. In others proof must go outside the instrument itself as we do here.

*Joiner*, 320 U.S. at 355.

Thus, *Joiner* does not even remotely suggest that the test applicable to "investment contracts" should be applied to every investment vehicle. Rather, consistent with *Joiner's* recognition that proof that a "security" is involved may be made by "proving the document itself" if the document is typical or by going "outside the instrument itself" if the document is atypical, this Court uniformly has applied a two-part test to determine whether a given instrument meets the federal securities laws' definition of a "security." Instruments that "on their face" are clearly among those instruments specifically described by the Congress in the Acts are treated as securities as a matter of course. If, for example, an instrument labeled "stock" carries with it the right to receive "dividends contingent upon an apportionment of profits," *Tcherepnin v. Knight*, 389 U.S. 332, 339 (1967), as well as all of the "other characteristics traditionally associated with stock," including negotiability, alienability, voting rights, and the possibility of appreciation in value, *Forman*, 421 U.S. at 851, the analysis ends. See *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982) (categorically stating that "ordinary stocks and bonds" are included in the statutory definition). The "economic reality" of the transaction creating the instrument is examined only if, as in *Joiner* and *Howey*, the instrument in question involves an economic arrangement not readily identified by one of



the statutory appellations, or if, as in *Forman*, the instrument in question has "none of the characteristics 'that in our commercial world fall within the ordinary concept of a security.'" *Forman*, 421 U.S. at 851, quoting H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933). And the transaction the Court has examined is the transaction which endows the instrument with the bundle of rights it represents, not the transaction in which it is exchanged. See *Marine Bank*, 455 at 559 n.9 ("We reject respondent's argument that the certificate of deposit was somehow transformed into a security when it was pledged, even though it was not a security when purchased.").<sup>23</sup>

This two-part test, which correctly recognizes that stock and the other listed instruments have a meaning different from "investment contract," is required by well-settled canons of statutory construction. This Court has repeatedly held that every word in a statute is to be

<sup>23</sup> In determining whether an instrument is a "security," the appropriate focus must be upon the transaction which created the instrument, not every subsequent transaction in which it is exchanged. This Court always has looked to the transaction which created the instrument. *Joiner* and *Howey* were both actions brought by the SEC to enjoin violations of the registration requirements of the Securities Act of 1933, in which the question necessarily was whether the interests in oil leases and orange groves, respectively, were "securities" when they were "issued." *Tcherepnin*, *Daniel*, *Forman*, and *Marine Bank* all involved fraud claims. In each of those cases the plaintiff was the original purchaser of the instrument in question. To the extent the Court found it necessary to examine the "economic realities" of the "transaction," it was obviously the transaction in which the putative security was issued that was the relevant one. And in *Marine Bank* this Court explicitly rejected the proposition that the same instrument could fail to be a "security" when created, but become one at some later time. *Marine Bank*, 455 U.S. at 559 n.9. If the Ninth Circuit had been faithful to these cases it would have focused upon the transaction by which the shares were issued to the Landreths, not the transaction in which the Landreths sold them to Messrs. Bolten and Dennis.

given meaning, *United States v. Menasche*, 348 U.S. 528, 538-39 (1955). Indeed, just this term, the Court reaffirmed that "[c]anons of construction indicate that terms connected in the disjunctive . . . be given separate meanings." *Garcia*, 53 U.S.L.W. at 4017. Any argument that the definition of an "investment contract" should apply to all of the instruments which are separated from "investment contract" by the disjunctive "or" offends both canons.

The definitional section of the 1933 Act lists seventeen forms of instruments and separates the sixteenth from the seventeenth by the disjunctive conjunction "or." 15 U.S.C. § 77b(15). The 1934 Act lists fourteen instruments, again employing the disjunctive "or." This Court recently declared that such a statutory scheme indicates Congress' "intent to give the nouns their separate, normal meaning," *Garcia*, 53 U.S.L.W. at 4017, thereby giving each word meaning. *Menasche*, 348 U.S. at 538-39. The imposition of *Howey*'s "investment contract test" on every other term in the statutory definition not only deprives those terms of any separate meaning, but also renders them meaningless, and offending both canons.

**2. The Two-Part Test for Determining Whether an Instrument Is a "Security" Is Not Undermined by, but Instead Is Required by, *Howey*, *Forman*, and Other Decisions of This Court Applying the Definitional Sections of the Federal Securities Laws.**

Both *Howey* and *Forman* are consistent with, and indeed require, the two-part test to determine whether an instrument is a "security." *Howey* considered the sale of land used as citrus groves coupled with a service contract. Recognizing that the lower courts had "treated the contracts and deeds as separate transactions involving no more than an ordinary real estate sale and an agreement by the seller to manage the property for the buyer," *Howey*, 328 U.S. at 297-98, the Court noted that

the term "investment contract" was undefined in the 1933 Act, "but had been broadly construed by state courts" applying state blue sky laws. The Court held that Congress' use of the term "investment contract" in the 1933 Act imported the state definitions so that "investment contract" meant

a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

*Howey*, 328 U.S. at 298-99. Precisely because the concept of an "investment contract" was meant to be "one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," *id.* at 299, it was necessary, as *Joiner* had recognized, to go outside the instrument to determine whether an "investment contract" was present. *Joiner*, 320 U.S. at 355. And, as in *Joiner*, the Court looked to the transaction which created the instrument to determine what attributes it possessed and inducements it offered.

Similarly, in *Forman*, upon which the Ninth Circuit and the other proponents of the "doctrine" rely most heavily, this Court applied the *Howey* "investment contract" analysis only after it concluded that the instrument labeled "stock" was really a refundable, nontransferable deposit on a cooperative apartment lacking any expectation of dividends or a return on the purchase price. Although the Court rejected the suggestion that transactions "evidenced by the sale of shares called 'stock,'" were automatically covered by the provisions of the federal securities laws "simply because the statutory definition of a security includes the words 'any . . . stock,'" *Forman*, 421 U.S. at 848 (footnote omitted), it did so

only after a thorough examination of the instruments involved revealed that the only similarity between those instruments and a traditional share of stock was their name.

In a separate section the *Forman* Court considered the alternative basis for the Court of Appeals' holding that the instrument was a "security." The Court of Appeals had held "that a share in [the cooperative apartments] is both 'stock' and an 'investment contract' under the Securities Acts." *Forman v. Community Services, Inc.*, 500 F.2d 1246, 1255 (2d Cir. 1974). It was only in rejecting what this Court labeled the "alternative ground" for the Court of Appeals' decision that the Court proceeded to apply the *Howey* analysis to the claimed "investment contract" before it. *Forman*, 421 U.S. at 351. *Forman*, therefore, stands only for the proposition that courts need not blindly follow a "literalist" approach and permit the name given to an instrument to mask the fact that, for example, a lease deposit has been called "stock."<sup>24</sup>

Ironically, courts adopting the "sale of business doctrine," including the Ninth Circuit in this case through the use of their "risk capital test," have principally relied upon *Forman*.<sup>25</sup> Yet as a number of other federal courts have already concluded, the structure of the *Forman* opinion repudiates the analysis underlying the doctrine:

[W]e think that *Forman* favors rejection of the sale of business rule. In treating separately the questions

<sup>24</sup> One court colorfully has recognized the common sense proposition that the name given an instrument cannot control by declaring that "[a] lizard with a sign around its neck reading 'dog' does not change the lizard into a Labrador retriever." *Slevin v. Pedersen Associates, Inc.*, 540 F. Supp. 437, 440 (S.D.N.Y. 1982).

<sup>25</sup> *Pet. A. 7a-9a. See also Christy v. Cambron*, 710 F.2d 669 (10th Cir. 1983); *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982); *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982).



whether the shares at issue were stock or investment contracts, the decision as a whole suggests that as long as an instrument has the typical characteristics of stock, it need not also qualify as an investment contract under the *Howey* test.

*Daily v. Morgan*, 701 F.2d 496, 499 (5th Cir. 1983). And, most recently, this Court declared that the statutory definitions "include ordinary stocks and bonds, along with the 'countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'" *Marine Bank v. Weaver*, 455 U.S. 551, quoting *Howey*, 328 U.S. at 299 (emphasis supplied).

In this case the Ninth Circuit apparently dismissed as irrelevant the district court's finding that, unlike the "stock" in *Forman*, the shares of Landreth Timber had "all of the characteristics normally associated with stock." Pet. A. 13a. The Ninth Circuit proceeded immediately to the alternative ground of *Forman*, and held that the sale of a controlling number of shares in a corporation is not an "investment contract" and, therefore, the federal securities laws do not apply. Pet. A. 8a-9a. But *Forman* neither held nor suggested that a transaction involving an instrument with all the attributes of traditional stock must also meet the test applicable to "investment contracts." As the Fifth Circuit has noted, this "Court was not [in *Forman*] commanding that the *Howey* criteria apply to all securities, but was merely describing its past decisions, all of which dealt with unusual instruments where the *Howey* test would be applicable." *Daily*, 701 F.2d at 499-500 (footnote omitted).

Courts following the "sale of business doctrine" have misinterpreted this Court's opinions in yet another way. While this Court has held that certain instruments are not "securities," it has never suggested that the same instrument can be a "security" if exchanged in one transaction, but not a "security" if exchanged in another. See

*Marine Bank*, 455 U.S. at 559 n.9. Instead, this Court consistently has asked "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect." *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967), quoting *Joiner*, 320 U.S. at 352-53 (emphasis supplied). Only by ignoring the transaction which creates the instrument and focusing on some later exchange can a court create the "now it's a 'security,' now it's not" effect the "sale of business doctrine" produces. As the Second Circuit has recognized, the "doctrine's" focus on the nature of the transaction rather than on the nature of the instrument is contrary to this Court's decisions:

*Howey*, *Forman* and *Marine Bank* treat the determination of whether a particular instrument is a "security" under the '33 and '34 Acts as one which does not vary from time to time depending upon the relative holdings of the parties or their intentions in a particular transaction. . . . The sale of business doctrine, on the other hand, treats an instrument as a "security" for some purposes but not for others. Whereas prior cases have focused on the nature of the instrument, the sale of business doctrine focuses on the nature of particular transactions involving the instrument.

*Golden v. Garafalo*, 678 F.2d 1139, 1143-44 (2d Cir. 1982) (citation omitted).

Finally, the Ninth Circuit's belief that it was constrained to apply the "investment contract" analysis because of its earlier decisions involving notes is wrong. This Court has yet to consider whether a "note" with all the usual characteristics of traditional "notes" can ever fail to be a "security" under the federal securities laws. Some courts considering the issue, however, have concluded that some "notes" are covered by the Acts, and some "notes" are not.<sup>26</sup> Whatever may be the



ultimate resolution of the attempt to harmonize the varying bases advanced to exempt some "notes" from coverage, there is no warrant to extend the confusion to "stock." See generally *Ruefenacht*, 737 F.2d at 323-26 (analyzing cases). "Notes," unlike "stock," are a peculiarly broad class of financial instrument, having widely varying terms and conveying variable bundles of rights. As the Third Circuit stated in *Ruefenacht* in the course of explaining its earlier decision in *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973) (and providing the distinction between notes and stock the Ninth Circuit lacked):

[T]here is, as we held in *Lino*, some necessity for fine-tuning the definition of "note" to avoid sweeping within the coverage of section 10(b) of the 1934 Act every consumer and business loan financing current operational costs. But there is no such necessity in the stock area. Stock is a well-defined term, is not issued by consumers, and is not ordinarily employed by business to finance current transactions. While the importation of the *Howey* test into the note arena might be justified as an expedient—albeit an imperfect one—for limiting the definition of "note," no such expedient seems necessary for the issue of stock.

*Ruefenacht*, 737 F.2d at 325.

In its analysis of the shares of stock acquired by Messrs. Bolten and Dennis, the Ninth Circuit has strayed from the analysis employed in this Court's prior decisions. The Landreth stock concededly carried the usual attributes of instruments so named. The shares at issue entitled Messrs. Bolten and Dennis to "dividends contingent upon an apportionment of profits," *Tcherepnin*, 389 U.S. at 359, voting rights and all of the "other charac-

<sup>26</sup> See, e.g., *Exchange National Bank v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976); *Emisco Industries, Inc. v. Pro's Inc.*, 543 F.2d 38 (7th Cir. 1976); *McClure v. First National Bank*, 497 F.2d 490 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975); *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973).

teristics traditionally associated with stock." *Forman*, 421 U.S. at 851. In these circumstances, *Forman* does not require that a court look behind the name of an instrument specified in the statutes where there is no indication that the instruments are anything "other than what they appear to be." *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202, 1204 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979). Having been induced by representations of a profitable investment—the inducement normally motivating the purchase of stock—and having purchased ordinary common stock, Messrs. Bolten and Dennis are entitled to the protections provided by the federal securities laws to purchasers of stock.

### III. THIS COURT SHOULD ENFORCE THE PLAIN MEANING OF THE ACTS AND ADHERE TO ITS PRIOR DECISIONS. THIS COURT SHOULD REJECT THE UNNECESSARY CONFUSION IN THE APPLICATION OF THE FEDERAL SECURITIES LAWS, ILLOGICAL RESULTS, AND BURDENS ON COURTS AND LITIGANTS THAT WOULD RESULT FROM ADOPTING THE SALE OF BUSINESS DOCTRINE.

Application of the "sale of business doctrine," in whatever form it might take, would necessarily require this Court and the courts of appeals to formulate two complex legal standards and then require district courts to engage in two complex factual inquiries to determine whether federal jurisdiction exists. First, pursuant to whatever standard is proposed, the district court would be required to determine whether the stock sold carried with it the power of control. Second, if the "investor"/"entrepreneur" distinction is to be resolved by some principled standard rather than "form," the court must necessarily determine whether the purchaser's intent to exercise that power was sufficient to make him or them "entrepreneurs" rather than "investors." Resting federal jurisdiction on such uncertain foundations is unwise.

In the year the 1934 Act was passed, this Court construed the Ship Mortgage Act of 1920 to determine whether the federal courts had exclusive admiralty jurisdiction to adjudicate mortgage foreclosure suits. The Court declared, in terms equally applicable here:

If a mortgage is within the Act, there can be no suit to foreclose it in the state court; if the mortgage is not within the Act, there can be no suit for foreclosure in the admiralty. It cannot be doubted that the Congress recognized the importance of basing the jurisdiction, as thus sought to be conferred, upon precise statutory conditions. We find no warrant for leaving it to be tested by extrinsic criteria, raising a host of questions as to the application of the proceeds of loans, in the solution of which the statute affords no aid.

*Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21, 42 (1934) (footnote omitted). The "sale of business doctrine" invites courts to resolve questions of jurisdiction on just such "extrinsic criteria . . . in the solution of which the statute affords no aid." *Id.*

**A. The Determination of the Presence of Even Theoretical Control—the Fundamental Basis for the Doctrine—Is a Complex and Burdensome Legal and Factual Inquiry.**

According to the "sale of business doctrine," a transaction effecting change of control is not a transaction in "securities." But the imprecision of the so-called "doctrine" manifests itself when the legal and factual inquiries necessary to make that determination—upon which federal jurisdiction turns—is examined.

Perhaps the only aspect of the "doctrine" as to which even a surface level agreement exists among its proponents is that a transaction involving the sale of all the common stock of a corporation is not a transaction in "securities." But even at that level the doctrine produces confusion, and conflicts with its own rationale.

Limiting the doctrine to the sale of 100% of the shares makes no analytical sense. Only the form, not "economic realities," change if the purchaser ritualistically insists the seller retain a single share. Accordingly, the rationale of the "doctrine" has led some courts to declare that it must apply to all sales of any "controlling" interest in a business. See, e.g., *Sutter v. Groen*, 687 F.2d 197, 203 (7th Cir. 1982). See also *Christy v. Cambron*, 710 F.2d 669, 672 n.1 (10th Cir. 1983); *King v. Winkler*, 673 F.2d 342, 346 (11th Cir. 1982). Cf. *Daily v. Morgan*, 701 F.2d 496, 503 (5th Cir. 1983); *Golden v. Garafalo*, 678 F.2d 1139, 1145-46 (2d Cir. 1982).

But if the "doctrine" is true to its roots and applies to any transaction in which a "controlling" interest is sold, the courts will be required to determine, on a case by case basis, whether control has been transferred. In even the seemingly easiest cases—when all of the stock changes hands in a single transaction—questions will remain. Ownership of all of the voting stock of a corporation does not necessarily convey immediate "control." Most state corporation statutes, for example, authorize the election of director for staggered terms of greater than one year. E.g., Del. Code Ann. tit. VIII § 141(d) (1984); H. Henn and J. Alexander, *Laws of Corporations and Other Business Enterprises*, 556-57 (3d ed. 1983). In such a corporation, unless the shareholders are permitted to remove directors without cause (which is not always possible, see H. Henn and J. Alexander at 559), a person who acquires 100 percent of the stock of a corporation may not be able actually to assume working control for a period of more than a year.

The problem becomes far more difficult when less than all the stock is acquired. While holdings of over 50 percent usually convey the power to elect the entire board of directors, and thus to control the day-to-day operations of a corporation, this is not always the case. Provisions for cumulative voting, class voting, "staggered" boards



of directors and the like are often used in close corporations (and even occasionally in more widely-held ones) to limit the power or control of a majority shareholder. See H. Henn & J. Alexander, *Laws of Corporations and Other Business Enterprises* 719-22 (3d ed. 1983); F. H. O'Neal, *Close Corporations* §§ 3.14, 3.23 (1971). See also *Atlantic Properties, Inc. v. Commissioner*, 519 F.2d 1233 (1st Cir. 1975) (supermajority voting requirement for board action prevented effective action by board on dividends).

Such limitations are particularly common with respect to major actions that cannot be taken by the board of directors acting alone. Some state statutes require votes of an extraordinary majority (usually two-thirds) of the shareholders to accomplish certain transactions, such as mergers, amendments to the articles of incorporation, or sales of assets. *E.g.*, Del. Code Ann. tit. VIII § 102(b)(4) (1984). And the recent popularity of so-called "shark-repellent" provisions in the charters of publicly-held corporations have made such provisions increasingly common in the articles of public companies. See A. Fleischer, *Tender Offers: Defenses, Responses and Planning* (1983); M. Lipton and E. Steinberger, *Takeovers & Freezeouts* 265-71 (1978).

Conversely, in corporations in which the shares are widely dispersed, holdings of substantially less than fifty percent of the stock are sufficient to convey "working control." See *Essex Universal Corp. v. Yates*, 305 F.2d 572, 578-79 (2d Cir. 1962) (panel majority assumes "28.3 percent of the voting stock of a publicly-held corporation is usually tantamount to majority control . . ."); see also *Sutter v. Groen*, 687 F.2d at 203; Sommer, *Who's "In Control?"*—SEC, 21 Bus. Law. 559, 569 (1966) (less than 10 percent may be sufficient for control). Courts have recognized that it is extremely difficult to make such a determination.

The existence of [control] will depend not merely on the proportion of the stock held by the seller, but on many other factors—whether the other stock is widely or closely held, how much of it is in "street names," what success the corporation has experienced, how far its dividend policies have satisfied its stockholders, the identity of the purchasers, the presence or absence of cumulative voting, and many others.

*Essex Universal Corp. v. Yates*, 305 F.2d at 582 (Friendly, J., concurring).

At the very least, the trial court would have to conduct a complex and extensive hearing just to determine whether a sale of "control" occurred, an issue on which the court's jurisdiction will turn. And even that inquiry may not ultimately be successful. As Judge Friendly recognized in *Yates*:

Often, unless the seller has nearly 50% of the stock, whether he has "working control" can be determined only by an election; groups who thought they had such control have experienced unpleasant surprises in recent years.

*Id.* at 582.

When the present case, involving the ultimate transfer of 100% of Landreth Timber's stock, is analyzed according to the "economic realities," an apt example of the complexities in determining the existence of control is presented.<sup>27</sup>

In the securities laws, as in other areas of the law, a transaction involving a series of intermediate steps is properly analyzed by collapsing the formal, intermediate steps, and analyzing the completed transaction. See, *e.g.*, *Dobson v. Commissioner*, 320 U.S. 489 (1943);

<sup>27</sup> Despite the fact that it was deciding a case of "first impression," the Ninth Circuit declined to permit Mr. Dennis and Mr. Bolten's estate, the two major shareholders, to intervene. Pet. A. at 10a. That decision permitted the court to avoid analyzing the issue of control according to the "economic realities."



*Waterman Steamship Corp. v. Commissioner*, 430 F.2d 1185 (5th Cir. 1970), *cert. denied*, 401 U.S. 939 (1971); *SEC v. Culpepper*, 270 F.2d 241, 248 (2d Cir. 1959).<sup>28</sup> Viewed from that perspective, the transaction involved here resulted in Messrs. Bolten and Dennis acquiring 85% of the equity of Landreth Timber and 100% of the voting stock. Six others acquired the remaining 15% of the equity, without voting rights. Messrs. Dennis and Bolten each acquired 50% of the voting shares. Thus, neither had "control." To determine who had control, can a court conclusively presume that each shareholder would always vote as the other would? What sorts of disputes should a court hypothesize in predicting how a dispute would arise and be resolved—dividend policies, capital investment, or a re-"sale of the business?" Should it be open for Mr. Dennis or Mr. Bolten to contend that he was a passive "investor" expecting his partner to be an entrepreneur exercising control? Should such an inquiry be determined by each man's testimony concerning his subjective intent to be passive while his partner was active? Can that intent change as, for example, when the current employees reveal themselves to be unable to manage the business capably? In a case where a jury trial is demanded should a jury decide? Should the issue of jurisdiction be consolidated with the trial on the merits, or should full blown discovery be taken on this limited issue with, for example, repetitive depositions on the merits? If the fraud were sufficiently egregious to invoke the criminal penalties of the securities laws, would a seller's guilt turn on each *victim's* intent?

Surely a doctrine whose centerpiece is "economic reality" would embrace each of those inquiries. Equally

<sup>28</sup> The SEC's rules also take this approach. For example, Rule 501 provides that in counting the number of purchasers to determine whether an offering is exempt from registration, a corporation is not counted as a single purchaser if it was organized to acquire the securities. Instead, the rule requires that the corporation be ignored and its shareholders counted individually. 17 C.F.R. § 230.501 (1984).

surely, those inquiries would deprive the "doctrine" of any utility as an aid to a court determining its jurisdiction.

In short, not only is it not clearly established what is meant by "control" in applying the "sale of business doctrine," even if a test can be agreed upon, its application will often call for a complex and perhaps lengthy factual inquiry.

**B. Examining the Subjective Intent of the Purchaser To Determine Whether They Should Be Classified as an Investor or an Entrepreneur Is an Equally Uncertain and Unrewarding Enterprise.**

The second element in the "sale of business doctrine" is apparently the intent of the purchaser. As the Seventh Circuit, the principal architect of the "doctrine," put it:

[T]he key to defining the scope of the securities laws is whether the transaction is primarily for commercial (i.e., motivated by a desire to use, consume, occupy or develop), or for investment purposes.

*Frederiksen*, 637 F.2d at 1150. See also *Sutter*, 687 F.2d at 202-03.

But other courts correctly have recognized that the basis for this subjective (and apparently determinative) distinction between "investment" intent and "entrepreneurial" intent is not readily apparent.

Just why investors who choose to engage in entrepreneurship in order to improve the performances of their investment cease to be "investors," and become instead exclusively "entrepreneurs," is something of a mystery.

*Ruefenacht*, 737 F.2d at 334; see also Note, *Repudiating the Sale-of-Business Doctrine*, 83 Colum. L. Rev. 1718, 1738-39 (1983).

Even the Seventh Circuit has recognized that the distinction between an investor and an entrepreneur is often "fuzzy." *Sutter*, 687 F.2d at 202. Indeed, that court has recognized that "[s]ometimes a person is both at once." *Id.* at 201. However, the "doctrine" is ap-

parently rooted in the notion that the securities laws were intended to protect "investors" but not "entrepreneurs," or those who purchase for "commercial" reasons, and prides itself on an ability to match the legal result to "economic realities." See, e.g., *Frederiksen*, 637 F.2d at 1150 (7th Cir. 1981). Yet a "doctrine" which applies to all purchasers of 100% of the stock sweeps within its orbit cases in which the purchaser is in economic reality truly an "investor"—one who neither intends, nor is able, to exercise his theoretical power to actively control the business, but instead seeks a profitable investment in a going concern in which he intends to rely on the managerial skills of others.

The present case aptly illustrates this flaw in the "doctrine" and the Ninth Circuit's error in affirming summary judgment. By any test of "economic realities," the real purchasers are Mr. Bolten, an 84 year old retired businessman, Mr. Dennis, a 67 year old attorney, and six others. The operations of Landreth Timber Company were in Tonasket, Washington. Mr. Bolten lived in Florida, and Mr. Dennis lived in Florida and Boston. They were motivated by representations concerning the profitability of an investment which they would not be required to operate. Neither had any experience in the operation of a lumber mill and neither intended to make a radical career change to become a lumberman. Instead, they made their purchase in reliance on the existing management of the company and insisted that Ivan K. Landreth accept a consulting agreement to assist in the transition. He was in fact left with so much practical power over the affairs of the company that he was able to boast that he continued to own the company and that Messrs. Bolten and Dennis merely contributed additional funds to complete reconstruction. R. 148, 2-3. To call Messrs. Bolten and Dennis "entrepreneurs" rather than "investors" is surely to exalt form over substance and to deprive the word of any useful meaning.

And, of course, any factual determination concerning a purchaser's intent is further complicated by the fact

that the purchaser's intent may change over time. Surely there is no basis in the facts or record to conclude that Messrs. Bolten and Dennis contemplated earning their living from a business in which they had no experience and which was 3,000 miles from their homes. That circumstances required them to become involved in an attempt to avoid the debacle of a foreclosure sale scarcely makes them "entrepreneurs." But if it does, can it mean that securities law claims which would have been valid had they remained passive are extinguished by efforts to minimize the damage suffered?

The Ninth Circuit avoided economic reality and held that the presence of theoretical "control" meant Messrs. Dennis and Bolten were not investors. The Seventh Circuit, on the other hand, has responded by creating a set of presumptions to assist in the resolution of the issue of the purchaser's intent. See *Sutter*, 687 F.2d at 203. Respondent may offer these presumptions in an effort to escape this thicket. But there is even less basis in the statutory language or legislative history for such judicially created presumptions than there is for the proposition that the sale of stock to one who intends to exercise control is not a "securities" transaction. The need to fashion such a set of presumptions only illustrates how far adrift the doctrine is from any statutory anchor. Surely, as this Court said only last term, "some clearer directive from Congress" is required before embarking on "such a nebulous inquiry" involving "such a marked departure from the literal meaning of the Act." *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 52 U.S.L.W. 4943, 4948 (U.S. June 28, 1984).

The jurisdiction of the federal courts over a particular dispute should be as clear and easily determinable as possible. *Detroit Trust Co.*, 293 U.S. at 42. Jurisdictional rules that make the very existence of federal jurisdiction turn on complex factual inquiries lead to increased, rather than decreased, burdens on courts and litigants. Too often, a time-consuming factual inquiry



into the bases of jurisdiction will end in a finding that there is no jurisdiction. Upon such a finding the entire dispute, including many issues already investigated in the federal hearings, will as is threatened here, be relegated to the state courts, after six years of litigation over jurisdiction. While Congress presumably is free, in creating federal causes of action, to mandate such a procedure, it seems particularly unwise for the courts to inject such uncertainties into federal causes of action by creating judicial exceptions to otherwise clear statutory language. The "sale of business doctrine" is just such an exception. Its adoption is both unwarranted and unwise.

### CONCLUSION

The plain meaning of explicit statutory language, well settled canons of statutory construction, the structure of the federal securities laws, and this Court's previous opinions require that common stock of a traditional business corporation be treated as a "security." Accordingly, the Ninth Circuit's judgment must be reversed, and the "sale of business doctrine" rejected.

Respectfully submitted,

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## **APPENDICES**

## APPENDIX A

Document Title	Doc. No. within Record *	Page within Doc.	Page of Brief
(Deposition of Ivan K. Landreth, Sr. at 117-20, Attachment B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	11-14	3
(Letter from Ivan K. Landreth, Sr. to Gene Graf dated November 9, 1976, Appendix B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	157	3
(Landreth Timber Company listing with brokers, Appendix B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	158	3
(Affidavit of Ivan K. Landreth, Sr. Opposing Plaintiff's Motion for Summary Judgment on Securities Claims ¶ 4)	R. 123,	2	3
(Deposition of Eugene Graf at 8, Attachment B to Affidavit of James A. Smith, Jr. dated September 25, 1980)	R. 69,	277	3
(Deposition of Ivan K. Landreth, Sr. at 6, Attachment B to Affidavit of James A. Smith, Jr. dated September 25, 1980)	R. 69,	222	3
(Deposition of Ivan K. Landreth, Sr. at 24, Attachment B to Affidavit of James A. Smith, Jr. dated September 25, 1980)	R. 69,	224	3
(Deposition of Ivan K. Landreth, Sr. at 132, Attachment B of Affidavit of James A. Smith, Jr. dated September 25, 1980)	R. 69,	233	3

\* The record filed with this Court is separated into numbered Documents, each Document indicated by a tabbed, numbered separator sheet. Individual pages within each tabbed Document were not numbered by the courts below. In making citations to the record, petitioner first cites the tabbed Document number and then provides a page number within the Document, page 1 being the Document page immediately following the tabbed separator sheet.

## 2a

Document Title	Doc. No. within Record	Page within Doc.	Page of Brief
(Deposition of Eugene Graf at 69, Attachment B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	44	3
(Deposition of Eugene Graf at 175, 178, 182 and 249-69, Exhibit B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	51, 54,56, 66-83	3
(Deposition of Jack Branch at 24, Exhibit B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	87	3
(Deposition of Phillip A. Cook at 468-69, Attachment to Affidavit of John W. Hathaway dated November 25, 1980)	R. 108,	76-77	4, 4 n.5
(Deposition of Ivan K. Landreth, Sr. at 93-95, Attachment to Affidavit of John W. Hathaway in Support of Plaintiff's Motion for Summary Judgment on Securities Claim)	R. 114,	3-5	4, 4 n.5
(Supplemental Affidavit of Samuel S. Dennis in Opposition to Defendants' Motion for Summary Judgment ¶ 7)	R. 148,	4-5	4
(Affidavit of Peter Townsend in Support of Plaintiff's Motion for Summary Judgment ¶ 2)	R. 137,	2	5
(Deposition of Peter Townsend at 46, Attachment B to Affidavit of James A. Smith, Jr. dated September 28, 1980)	R. 69,	321	5
(Deposition of Peter Townsend at 87, Attachment B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	129	5
(Affidavit of Peter Townsend in Support of Plaintiff's Motion for Summary Judgment ¶ 7)	R. 137,	4-5	5
(Deposition of Peter Townsend at 102, Attachment B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	131	5

## 3a

Document Title	Doc. No. within Record	Page within Doc.	Page of Brief
(Affidavit of Peter Townsend in Support of Plaintiff's Motion for Summary Judgment ¶¶ 3, 7 and 9)	R. 137,	2, 4-5, 5-6	5
(Affidavit of Peter Townsend in Support of Plaintiff's Motion for Summary Judgment ¶¶ 4-7)	R. 137,	2-5	5
(Affidavit of Peter Townsend in Support of Plaintiff's Motion for Summary Judgment ¶ 6)	R. 137,	3-4	5 n.7
(Landreth Timber Company listing with brokers, Appendix B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	158	6
(Deposition of Ivan K. Landreth, Sr. at 121-22, Attachment B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	15-16	6
(Landreth Timber Company listing with brokers, Appendix B to Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	158	6
(Affidavit of Ivan K. Landreth, Sr. Opposing Plaintiff's Motion for Summary Judgment on Securities Claims ¶ 4)	R. 123,	2	6
(Deposition of Ivan K. Landreth, Sr. at 73, Attachment B to the Affidavit of John W. Hathaway dated November 7, 1980)	R. 93,	5	8
(Deposition of Phillip A. Cook at 693-94, 729-32, and 734, Attachment to Affidavit of John W. Hathaway dated November 25, 1980)	R. 108,	103-04, 102, 104, 106-09, 111	8
(Supplemental Affidavit of Samuel S. Dennis in Opposition to Defendants' Motion for Summary Judgment ¶ 7)	R. 148,	4-5	8 n.9
(Supplemental Affidavit of Samuel S. Dennis in Opposition to Defendants' Motion for Summary Judgment ¶¶ 3-5)	R. 148,	2-4	8



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(Deposition of Phillip A. Cook at 228-30, 243, 283 and 1005-06, Attachment to Affidavit of John W. Hathaway dated November 25, 1980)	R. 108,	41-43, 46, 58, 131-32	8
(Deposition of Phillip A. Cook at 243, Attachment to Affidavit of John W. Hathaway dated November 25, 1980)	R. 108,	46	9
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(Deposition of Phillip A. Cook at 517-18, Attachment to Affidavit of John W. Hathaway dated November 25, 1980)	R. 108,	81-82	9
(Memorandum in Support of Defendants' Motion for Summary Judgment on Securities Claims at 11-12, dated September 25, 1980)	R. 68,	11-12	10
(Plaintiff's Motion for Summary Judgment on Securities Claims at 1, dated January 7, 1981)	R. 115,	1	10
(Supplemental Affidavit of Samuel S. Dennis in Opposition to Defendants' Motion for Summary Judgment ¶ 3)	R. 148,	2-3	42

## APPENDIX B

Statutory provisions containing the words "unless the context otherwise requires":

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12 U.S.C. §§ 1730a(a)(1), 1749bbb-2(a)	National Housing Act
15 U.S.C. § 77b	Securities Act of 1933
15 U.S.C. § 77ccc	Trust Indenture Act of 1939
15 U.S.C. §§ 78c(a), 78u(h)(13)	Securities Exchange Act of 1934
15 U.S.C. § 79b(a)	Public Utility Holding Company Act of 1935
15 U.S.C. § 80a-2(a)	Investment Company Act of 1940
15 U.S.C. § 80b-2(a)	Investment Advisers Act of 1940
15 U.S.C. § 717a	Natural Gas Act
15 U.S.C. § 1821	Horse Protection Act
15 U.S.C. § 2903	National Climate Program Act
15 U.S.C. § 3703	Stevenson-Wydler Technology Innova- tion Act of 1980
16 U.S.C. § 715n	Migratory Bird Conservation Act of 1929
16 U.S.C. § 1802	Magnuson Fishery Conservation and Management Act
16 U.S.C. § 2802	National Aquaculture Act of 1980
19 U.S.C. § 1202	Tariff Act of 1930
20 U.S.C. § 1132(b)	Higher Education Act of 1965
30 U.S.C. § 351	Mineral Leasing Act for Acquired Lands
33 U.S.C. § 1001	Oil Pollution Act, 1961, as amended
33 U.S.C. § 1222	Ports and Waterways Safety Act
33 U.S.C. § 1502	Deepwater Port Act of 1974
33 U.S.C. § 1702	National Ocean Pollution Planning Act of 1978
39 U.S.C. § 102	Postal Reorganization Act

United States Code (1982)	Short Title of Act(s)
42 U.S.C. § 201 (c)	Public Health Service Act
42 U.S.C. § 1395hh	Health Insurance for the Aged Act
42 U.S.C. § 3002	Older Americans Act of 1965
42 U.S.C. § 4003 (a)	Flood Disaster Protection Act of 1973
42 U.S.C. § 7703	Earthquake Hazards Reduction Act of 1977
42 U.S.C. § 9102	Ocean Thermal Energy Conversion Act of 1980
44 U.S.C. § 1501	Printing and Binding Act
45 U.S.C. § 702	Regional Rail Reorganization Act of 1973
45 U.S.C. § 1104	Northeast Rail Service Act of 1981
46 U.S.C. § 888	Shipping Act, 1916
47 U.S.C. § 153	Communications Act Amendments, 1952
47 U.S.C. § 702	Communications Satellite Act of 1962
49 U.S.C. § 1301	Federal Aviation Act of 1958
50 U.S.C. § 466	Military Selective Service Act

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**In the Supreme Court of the United States**

**OCTOBER TERM, 1984**

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**LANDRETH TIMBER COMPANY, PETITIONER**

**v.**

**IVAN K. LANDRETH, ET AL.**

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***ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE NINTH CIRCUIT***

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**MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*  
and  
BRIEF FOR ADVANCE ROSS CORPORATION AS  
*AMICUS CURIAE* IN SUPPORT OF RESPONDENTS**

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Advance Ross Corporation, a Delaware corporation based in Chicago, Illinois, respectfully moves pursuant to Rule 36.3 of the Rules of this Court for leave to file a brief *amicus curiae* in support of respondents. The consent of counsel for petitioner and respondents has been requested but denied. Advance Ross Corporation's interest in this case, and its special perspective on the issues presented, are briefly described in this motion.

In December 1982, Advance Ross Corporation ("Advance Ross") sold a wholly-owned subsidiary, AMI Industries ("AMI"), to Algeran, Inc. ("Algeran"). That sale came in the aftermath of a six-month period of negotiation, repeated on-site inspections of AMI's premises, a review of AMI's receivables by accountants, and a disclosure of non-public records and data

requested by Algeran. The parties embodied their purchase agreement in a 64-page contract, which was negotiated by experienced corporate lawyers and which contained extensive warranties and covenants concerning the rights and obligations of the purchaser and seller. Among those covenants and warranties were specific promises concerning operations, assets, liabilities, and the accuracy of financial information. See Add., *infra*, A-6 to A-24. The parties expressly agreed that any disputes concerning the sale transaction or breaches of any warranty or covenant were to be decided under California law (*id.* at A-23), and that all such disputes were to be resolved by arbitration rather than by judicial proceedings. *Id.* at A-23 to A-24, A-19 to A-20.

The purchase agreement between Advance Ross and Algeran transferred control over AMI by conveying 97% of its stock. The remainder of the shares were lost shares; the transferred shares therefore represented all existing and identifiable stock. Algeran paid Advance Ross the purchase price part in cash and part in promissory notes secured by a pledge of AMI's stock. Immediately after the sale transaction, Algeran assumed control of AMI, installed a new board of directors, and began to manage the company as its own wholly-owned subsidiary (Add., *infra*, A-1 to A-3, A-20).

Within two business days after the closing of the sale, Algeran began to complain about alleged "nondisclosures" in the sale negotiations and demanded a reduction in the purchase price. Despite its unequivocal promise to arbitrate, Algeran claimed a right to sue in federal court under the securities laws by reason of this Court's decision in *Wilko v. Swan*, 346 U.S. 427 (1953), which, it asserted, overrode the unambiguous arbitration covenant.

Algeran then filed a complaint in the United States District Court for the Central District of California, alleging various purported nondisclosures in violation of the securities laws. A

lengthy period of discovery ensued. During that period of discovery, Advance Ross uncovered proof that Algeran's principals previously had purchased several other corporations and had used litigation to coerce decreases in the purchase price. Moreover, they reduced at least two of the corporations which they purchased to worthless shells after acquisition. Appendix in Support of Motion for Summary Judgment at 1-153.

Throughout the lengthy pretrial proceedings that resulted from Algeran's initiation of securities litigation and its refusal to arbitrate, Algeran relied on the pendency of securities litigation to delay foreclosure on the AMI stock which Advance Ross held as collateral. Advance Ross therefore was forced to stand by helplessly while its collateral dwindled in value due to Algeran's extraction of funds from AMI. Ultimately, both Algeran and AMI filed bankruptcy petitions.

Algeran's delaying tactics could have continued indefinitely given the amount of time that it takes to resolve a securities case in federal court. However, approximately a year and a half after Algeran filed its securities complaint, the Ninth Circuit decided the case of *Landreth Timber Co. v. Landreth*, 731 F.2d 1348 (9th Cir. 1984), which affirmed the sale of business doctrine and which held that privately negotiated sales of substantially all of the stock of a corporation are beyond the scope of the federal securities laws.

Applying the Ninth Circuit's decision in *Landreth*, the district court dismissed Algeran's securities law claims. After dismissal of those securities law claims, *Wilko v. Swan* no longer stood as an obstacle to arbitration and the district court enforced the arbitration agreement. The court observed that "arbitration may well be the speediest method of resolving the claims in this case." Add., *infra*, at A-3. Moreover, having dismissed the securities law claims, the district court also permitted Advance Ross to exercise its contractual rights as a secured creditor—rights which had been hindered for over a year and a half by Algeran's initiation of securities litigation.

In view of these recent events, it is apparent that this Court's decision concerning the validity of the sale of business

doctrine may have a substantial impact on the final resolution of the controversy between Algeran and Advance Ross. Accordingly, Advance Ross has a direct interest in the outcome of this litigation.

In the Algeran litigation, as in the case now before this Court, federal jurisdiction was premised on the assumption that a privately negotiated sale of all of the stock of a corporation is a "security" transaction subject to the federal securities laws. As we demonstrate in this *amicus* brief, that assumption is totally unfounded. This brief also demonstrates the far-reaching importance of the sale of business doctrine and the danger of "vexatious litigation" (*Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975)) which would follow from a rejection of that doctrine. In particular, this brief describes the injustice and waste that result from condoning evasion of negotiated sale agreements by resort to securities litigation. Superimposing securities law remedies would effectively strip away contractual remedies negotiated by sophisticated parties of equal bargaining power, and would nullify express covenants to arbitrate which are essential to many sale of business transactions.

In view of Advance Ross Corporation's recent experience with sale of business litigation, its views on the legal and policy issues raised by this case should materially assist the Court and provide a useful supplement to the presentation of respondents.

Respectfully submitted,

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## QUESTION PRESENTED

Whether a privately negotiated sale of business, which is evidenced by a transfer of all of the stock of a closely-held corporation and which is accompanied by the purchaser's assumption of control over all of the assets and operations of the corporation, is in economic reality a sale of "securities" within the meaning of the federal securities laws.



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## BRIEF FOR ADVANCE ROSS CORPORATION AS AMICUS CURIAE

### INTEREST OF THE AMICUS CURIAE

As explained in the foregoing motion for leave to file the instant brief *amicus curiae*, Advance Ross Corporation has a direct interest in the present case because it is now a defendant in a suit which raises the validity of the sale of business doctrine (see Add., *infra*, at A-1 to A-3).

### STATEMENT

1. The sale of business involved in this case resulted from three months of private negotiation between respondents, the owners of a closely-held family corporation, and a representative of petitioner, a senior partner in a major law firm who was experienced in corporate acquisitions. J. App. 80-81, 264. Each side to the negotiations was represented by counsel. *Id.* at 171, 286. During the negotiations, the purchaser's agents conducted an extensive investigation of the acquired business—an inoperable sawmill then under reconstruction. In addition to personally visiting the premises, they retained an engineering firm which analyzed the underlying assets, a certified public accountant who investigated the financial condition of the business, and a bank officer who examined the operation of the business before providing financing. *Id.* at 84-86, 105-171, 217, 225-247. The purchaser's right to conduct a "pre-acquisition audit of the business and records of the company" (*id.* at 217) encompassed every feature of the financial and business operations of the acquired entity, including confidential financial information, relations with customers, equipment and inventories, past earnings records and income tax returns, corporate minute books, cash flow projections, and internal controls. *Id.* at 84-86, 106-111, 115, 127, 139, 154, 225.



The negotiated purchase agreement, providing for payment in cash and notes over an extended period of time in exchange for all of the stock of the acquired company, exceeded 60 pages in length. J. App. 206-274. The agreement contained comprehensive inventories and appraisals of the "physical assets" of the acquired company (*id.* at 210, 235-250), and a host of specially negotiated "warranties" by the sellers relating to assets, liabilities, and operations (*id.* at 208-213, 217-218, 227-233). In addition, the purchase agreement contained specific provisions designed to remedy any inaccuracy in the assurances and warranties made in the inducement of the transaction. The agreement provided that all "representations and warranties made by Sellers to Buyer \* \* \* in this Agreement or any document furnished or to be furnished by any of them hereunder shall be true and correct in all material respects" (*id.* at 215). It also prescribed a remedial mechanism to deal with any breach of warranty or promise, including a formula for computing damages to be paid (*id.* at 218-219). Although the purchase agreement made repeated reference to the "laws of the state of \* \* \* incorporation" and the "Uniform Commercial Code" (*id.* at 215-216), it nowhere referred to the provisions of the federal securities laws. The record contains no indication that the parties to the transaction expected the federal securities laws to govern their respective rights and obligations.

2. Following the closing of the sale transaction, the acquiring corporation assumed complete control over the business and operated it subject to its own managerial policies. The sellers retained no interest in the business and all of the former directors and officers resigned their positions. J. App. 183-186, 284-285. Moreover, prior to the closing, the purchaser selected its own "general manager," who supervised the day-to-day

operations of the company. *Id.* at 187-201. It is undisputed that the sellers retained no control over the management of the business and had no ability to direct its operations after the closing.

Unfortunately, the purchaser did not succeed in operating the business profitably, and, some months after the acquisition, it accused the sellers of providing inaccurate information during the sale negotiations. J. App. 90-94. The purchaser subsequently filed suit in the Superior Court for the State of Washington, *Landreth Timber Company v. Ivan K. Landreth*, Civ. No. 80-2-11740-8, a suit which alleged, *inter alia*, breach of contract and warranty and common law deceit. The purchaser also filed suit in federal district court, raising the same allegations presented in state court and asserting jurisdiction under the federal securities laws. J. App. 37-50.

3. The district court granted summary judgment and dismissed the securities law complaint, concluding that Congress never intended the federal securities laws to apply to privately negotiated sales of an entire business. Pet. App. 12a-20a. Looking to the "economic realities," the district court found that the transfer of stock certificates was merely incidental to the consummation of a "commercial" transaction (*id.* at 18a), and that the purchaser, who fully intended to own and operate the business itself, did not expect to earn profits "from the managerial or entrepreneurial efforts of others" (*id.* at 19a-20a.).

The court of appeals unanimously affirmed. Pet. App. 1a-10a. Speaking for the court, Chief Judge Browning explained that the "underlying transaction involved the sale of an entire business \* \* \*. Following the transaction, [the purchaser] had full control of the corporation, including the day-to-day operations of the mill and its employees. In 'economic reality,' the underlying transaction was a sale of a lumber business and \* \* \* not an investment in a 'security.'" *Id.* at 9a.

## INTRODUCTION AND SUMMARY OF ARGUMENT

The court of appeals correctly concluded that the "economic reality" of the transaction in this case was a sale of business and not an investment in securities. To treat the transaction as a purchase of "securities" would exalt form over substance. The purchaser in this case no more purchased "securities" than the purchaser of a home or automobile purchases a "deed of title" with his funds. The stock certificates transferred in this case, like a deed of title, merely formalized the transfer of ownership of the entire business enterprise—lock, stock and barrel. Because the purchaser here did not invest in certificates symbolizing a pro rata interest in an enterprise managed by others, and was in a position to negotiate on a one-on-one basis for information and contractual protection specially adapted to its needs, it did not engage in a "security" transaction within the meaning of the federal securities laws.

The language used by Congress is, of course, the starting point in any case of statutory interpretation. The definition of "security" contained in both the Securities Act of 1933, 15 U.S.C. 77b, and the Securities Exchange Act of 1934, 15 U.S.C. 78c(a), provides that the term "security" shall include "stock" — "unless the context otherwise requires." As this Court held in *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982), that express caveat is an important restriction on the broad language used in the definitional provisions: "The broad statutory definition is preceded \* \* \* by the statement that the terms mentioned are not to be considered securities 'if the context otherwise requires \* \* \* .' [W]e are satisfied that Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud." The Court in *Weaver* then proceeded to carefully analyze the economic reality surrounding two transactions, both of which fit within the definitions prescribed by Congress, but both of which, upon examination, were found to be commercial in nature and beyond the scope of Congressional intent.

That Congress did not mean to subsume privately negotiated sales of entire businesses within the statutory definition of a "security" sale is manifest from a consideration of the meaning of the terms "stock" and "security" when Congress enacted the federal securities laws. In this respect, it is appropriate to examine contemporary dictionary definitions. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 nn. 20-21 (1976) (relying on *Webster's International Dictionary* (2d ed. (1934))). *Webster's International Dictionary* (2d ed. 1934) establishes that the meaning of the term "stock" was "[s]hares or holdings, collectively, in a corporate business enterprise \* \* \*," while the term "security" referred to "[a]n evidence of debt or of property, as a bond [or] stock certificate, \* \* \* a document giving the holder the right to demand and receive property not in his possession." *Id.* at pp. 2480, 2263 (emphasis supplied). Thus, fifty years ago, the words "stock" and "security" denoted precisely what they denote today: collective holdings which symbolize the financial interest of investors in the assets of a business enterprise not in their possession.

It is contrary to the "ordinary concept of a security" transaction (*United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851 (1975)) to treat the sale of an entire business—in which stock is transferred as a mere incident of a conveyance of ownership and control—as a sale of "securities." In such a transaction, there is no "collective" investment in a venture managed by others, but rather the transfer of an entire business, including its physical assets, to be operated by the purchaser alone. Certainly, the average person, giving the words used by Congress their ordinary meaning, would not perceive this to be an investment in securities as opposed to the outright purchase of a business enterprise.

This view of the economic realities surrounding a sale of business is particularly compelling in the present case, where the purpose of the purchaser was not to acquire investment securities but rather to obtain control of the physical assets of



the enterprise. As the purchaser's representative explained (J. App. 83): "I told defendant Landreth that we wanted to purchase the operating assets and inventory of the sawmill from Landreth Timber Company. I informed Mr. Landreth that I was reluctant to purchase the corporate shares \* \* \*." The fact that the transaction ultimately took the form of a stock transfer, rather than an asset transfer, rested solely on tax considerations that are irrelevant to the expectations of the parties regarding the law that would govern a dispute such as this. *Id.* at 83, 107.

The courts of appeals in four circuits have concluded that the sale of a corporation, accompanied by a transfer of all of its stock in a privately negotiated transaction, is a sale of business and not a securities sale.<sup>1</sup> That view is supported by the great weight of academic scholarship.<sup>2</sup> As we demonstrate in this brief, that view also is compelled by this Court's past decisions, by the legislative history of the federal securities laws, by principles of federalism, and by the compelling need to prevent the federal securities laws from being used as instruments for the infliction of fraud and the destruction of contractual rights.

<sup>1</sup> See *Landreth Timber Co. v. Landreth*, 731 F.2d 1348, 1350-1353 (9th Cir. 1984); *Christy v. Cambron*, 710 F.2d 669, 672 (10th Cir. 1983); *Sutter v. Groen*, 687 F.2d 197, 199-204 (7th Cir. 1982); *Kaye v. Pawnee Constr. Co.*, 680 F.2d 1360, 1366 n. 2 (11th Cir. 1982); *King v. Winkler*, 673 F.2d 342, 345-346 (11th Cir. 1982); *Canfield v. Rapp & Son, Inc.*, 654 F.2d 459, 463-466 (7th Cir. 1981); *Frederiksen v. Poloway*, 637 F.2d 1147, 1150-1154 (7th Cir. 1981); and *Chandler v. Kew, Inc.*, 691 F.2d 443, 444 (10th Cir. 1977).

<sup>2</sup> See, e.g., Easley, *Recent Developments In The Sale Of Business Doctrine*, 39 *Business Lawyer* 929 (1984); Thompson, *The Shrinking Definition Of A Security: Why Purchasing All Of A Company's Stock Is Not A Federal Security Transaction*, 57 *N.Y.U.L. Rev.* 225 (1982); Seldin, *When Stock Is Not A Security: The Sale Of Business Doctrine*, 37 *Business Lawyer* 637 (1982).

## ARGUMENT

### THE FEDERAL SECURITIES LAWS DO NOT APPLY TO PRIVATELY NEGOTIATED SALES OF ALL OF THE STOCK OF A CORPORATION WHEN THE STOCK IS TRANSFERRED AS AN INCIDENT OF AN UNLIMITED TRANSFER OF OWNERSHIP AND CONTROL OVER THE BUSINESS ENTERPRISE

#### I. This Court's Recent Decisions Construing The Term "Security" Strongly Support The Sale Of Business Doctrine

1. In their briefs in this Court, petitioner and the SEC depend heavily on lower court decisions, and give grudging mention to the three latest decisions of this Court defining the term "security." That is not surprising, since their theories are irreconcilable with those recent decisions. Unlike petitioner and the SEC, we begin with what this Court recently has said on the subject at hand.

*a.* This Court enunciated the contemporary approach to defining the term "security" in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975). The plaintiffs in *Forman* alleged that "shares of stock" in a housing cooperative were investment securities subject to the federal securities laws. Plaintiffs claimed that because the shares were denominated "stock" and were purchased for value, they fell literally within the statutory definition of the term "security" and also constituted "investment contracts." In words that are directly applicable here, this Court rejected both contentions.

The Court began by observing generally that "stock" does not "fall within the ordinary concept of a security" unless it is sold "by those who seek the use of the money of others on the promise of profits." 421 U.S. at 848. Thus, the Court "reject[ed] at the outset any suggestion that the present transaction, evidenced by the sale of shares called 'stock,' must be considered a security transaction simply because the statutory



definition of a security includes the words 'any stock.'" *Ibid.* Rather, in considering the scope of the term "stock," the Court found it essential to place "emphasis \* \* \* on economic reality." *Ibid.* Stated otherwise, "[b]ecause securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto." *Id.* at 849. Viewing the economic realities underlying the purchase of stock in *Forman*, this Court held that the plaintiffs, who sought to acquire real estate "for their personal use," were not, in fact, "purchasing investment securities" even though the transaction was evidenced by a sale of stock. *Id.* at 851.

When the Court in *Forman* turned next to plaintiffs' claim that the certificates constituted "investment contracts," it utilized the same "economic reality" test used in analyzing the question whether the certificates were "stock," emphasizing that "we again must examine the substance — the economic realities of the transaction — rather than the names that may have been employed by the parties." *Id.* at 851-852. The economic realities test required a careful analysis of whether "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 852. "This test, in shorthand form, embodies the essential attributes that run through *all* of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *Ibid.* (emphasis supplied).

*Forman* also announced the standard used to distinguish between security transactions and commercial transactions: "when a purchaser is motivated by a desire to use \* \* \* the item purchased — 'to occupy the land or to develop it themselves' \* \* \* — the securities laws do not apply." *Id.* at 852-853. Even though the purchasers in *Forman* had an economic motivation for acquiring the stock in question, this Court found that "that

type of economic interest characterizes every form of commercial dealing." It added that "[w]hat distinguishes a security transaction — and what is absent here — is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases [an asset] \* \* \* for personal use." *Id.* at 858.

Thus, because the economic reality of the transaction at issue in *Forman* was a purchase of property to be used by the purchasers themselves — rather than payment of money to a third party with the expectation of profit from the third party's entrepreneurial efforts — this Court declined to find a security transaction despite the presence of certificates labelled "stock."

*b.* Proper application of *Forman* in the present case is clear. Here, as in *Forman*, the fact that stock certificates changed hands is not dispositive. In construing the federal securities laws, the Court must assess the economic reality of the underlying transaction. Here, as in *Forman*, no one placed money in the hands of others with the expectation of profit from their managerial efforts and here, as in *Forman*, there was no common venture. Quite to the contrary, the purchaser acquired property to be used by itself. Unlike a true security transaction, the purchaser here did not part with control over its investment. The present transaction is no different from the countless other transactions in our commercial world in which a purchaser acquires property to be used for profit-making purposes and obtains a transferable certificate to evidence its right of ownership.

What *Forman* recognizes, and what the court below also recognized, is that documents evidencing an ownership interest can be transferred in two fundamentally different contexts. In the first situation, the purchaser obtains a document reflecting its right of ownership at the same time that it obtains exclusive possession of the underlying property. The document formalizes undivided ownership. Examples include purchases of real estate or chattels in which cash is exchanged for a transferable

deed of title. By contrast, a security transaction arises when the purchaser obtains a document representing a fractional equity interest at the same time that he places capital in the hands of managers who are expected to earn profits for investors at large.

In this case, as in *Forman*, the acquiring party received stock certificates merely to formalize its ownership of property that it intended to manage itself. And here, as in *Forman*, the certificates did not have the significant "characteristics" of securities in the hands of investors (*id.* at 851). While ordinary investors purchase stock to obtain "dividends contingent upon an apportionment of profits" (*ibid.*), the certificates here were acquired to serve the formal function of a bill of sale or deed of title. The purchaser's profits were not "contingent" on any "apportionment of profits" by managers, but on its own managerial efforts. Moreover, as in *Forman*, "voting rights" and market "appreciat[ion]" had nothing to do with this stock acquisition. *Ibid.* The purchaser acquired the sawmill not to vote shares or speculate in the stock market, but to make money cutting logs (J. App. 83).

It would be exalting form over economic substance to treat a sale of business such as this as a sale of investment securities. Here, the "stock \* \* \* merely was passed incidentally as an indic[um] of ownership of the business assets." *Frederiksen v. Poloway*, 637 F.2d 1147, 1151-1152 (7th Cir. 1981). Since a sale of assets unquestionably would not be encompassed by the securities laws, the form of the transaction (ordinarily dictated by tax planning considerations) should not alter the result.

2. a. This Court's unanimous decision in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979),

provides additional compelling reasons for sustaining the sale of business doctrine. In *Daniel*, the plaintiffs alleged that participations in an involuntary, noncontributory pension plan were securities. The financial interests in *Daniel* were part of the compensation package which the plaintiffs received as employees. The interests resembled interests in a commingled mutual fund and were managed by professional fiduciaries. In view of this, the plaintiffs in *Daniel* contended that the financial interests constituted an "investment contract" or a "participation in a profit-sharing agreement," both of which are contained in the definition of the term "security." This Court rejected both contentions.

Initially, the Court reiterated that the test "is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 439 U.S. at 558. That test is to be applied "in light of 'the substance — the economic realities of the transaction — rather than the names that may have been employed by the parties.'" *Ibid.* The Court declined to find "any broader meaning" in any of the alternative definitions contained in the securities laws, since the economic realities test "embodies the essential attributes that run through *all* of the Court's decisions defining a security." *Id.* at 558 n. 11 (emphasis supplied).

The Court in *Daniel* then turned to the question whether it was realistic to view the plaintiffs' acquisition of pension plan interests as an investment in securities. The Court held that it was not, explaining that "[i]n every decision of this Court recognizing the presence of a 'security' under the Securities Acts, the person found to have been an investor chose to give up a specific consideration in return for a separable financial interest with the characteristics of a security." *Id.* at 559. In *Daniel*, by contrast, "the purported investment is a relatively insignificant part of \* \* \* [the] \* \* \* total and indivisible \* \* \* package." *Id.* at 560. The "package" received by the plaintiff-



employees, viewed as a whole, "is substantially devoid of aspects resembling a security." *Ibid.*

In addition, the Court in *Daniel* found that the financial benefits expected by the plaintiff-employees were not dependent solely "on the efforts of the Fund's managers." *Id.* at 562. Rather, those financial benefits "would depend primarily on the employee's efforts to meet the vesting requirements." *Ibid.* Thus, the financial returns expected by the plaintiff-employees came from their own efforts and not "from the entrepreneurial or managerial efforts of others." *Id.* at 561.

Finally, this Court observed in *Daniel* that treating the employees' financial interests as securities was unnecessary to protect their rights. The Court explained that other remedial schemes, such as the Employee Retirement Income Security Act, provided ample protection and were preferable to "the indefinite and uncertain disclosure obligations imposed by the antifraud provisions of the Securities Acts." *Id.* at 569. Thus, extension of the federal securities laws to the transactions at issue would "serve[ ] no general purpose." *Id.* at 570.

b. *Daniel* confirms that the court of appeals correctly declined to expand the scope of the federal securities laws in this case. Here, as in *Daniel*, it is completely unrealistic to speak of petitioner's acquisition of a business enterprise as a purchase of "securities." Petitioner clearly did not "give up a specific consideration in return for a separable financial interest with the characteristics of a security." 439 U.S. 559. Unlike the ordinary investor, who obtains only stock certificates and does not obtain ownership and control of the underlying physical assets, the purchaser here acquired a business operation in its entirety.

In addition, here, as in *Daniel*, the profits expected by petitioner were to come not from the managerial or entrepreneurial efforts of "others" (*id.* at 561), but rather from petitioner's own efforts (*id.* at 562). Finally, here, as in *Daniel*, it is totally unnecessary to extend the "indefinite and uncertain

disclosure obligations imposed by the antifraud provisions of the Securities Acts" (*id.* at 569) because there is an alternative and superior remedial scheme. The parties have prescribed in detail precisely how their rights and obligations are to be measured in the 60-page sale agreement, which contains comprehensive and carefully negotiated covenants and warranties. In this context, application of the federal securities laws would "serve no general purpose." *Id.* at 570.

3. a. This Court's unanimous decision in *Marine Bank v. Weaver*, 455 U.S. 551 (1982), removes any remaining doubt about the correctness of the decision of the court below. The plaintiffs in that case alleged that sales of a "certificate of deposit" and a "business agreement" constituted securities transactions. The certificate of deposit contained a promise to repay a sum certain plus interest, and fell literally within the statutory definition of the term security, which embraces any "note." Likewise, the business agreement provided for a sharing of profits from a commercial enterprise managed by other persons. It therefore literally fell within the statutory definition, which embraces any "profit-sharing agreement" or "investment contract."

Applying the economic realities test, however, this Court concluded that neither financial interest constituted a security. In rejecting plaintiffs' expansive arguments under the securities laws, the Court warned that "we are satisfied that Congress \* \* \* did not intend to provide a broad federal remedy for all fraud." 455 U.S. at 556.

Turning to the certificate of deposit, the Court stated that "[t]he definition of 'security' in the 1934 Act provides that an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires. It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of



deposit are abundantly protected under [other applicable] laws." *Id.* at 558-559.

The Court also concluded that the profit sharing agreement was beyond the scope of the securities laws. The Court acknowledged that "the agreement gave the [purchasers] a share in the profits of the slaughterhouse which would result from the efforts of the [sellers]." *Id.* at 559. Nonetheless, because the transaction was privately negotiated, it had none of the characteristics commonly associated with a securities transaction. The instruments "found to constitute securities in prior cases involved offers to a number of potential investors, not a private transaction as in this case." *Ibid.* The Court explained that "[h]ere, \* \* \* the [sellers] distributed no prospectus to the [purchasers] or to other potential investors, and the unique agreement they negotiated was not designed to be traded publicly." *Id.* at 560.

Finally, the Court observed that the plaintiffs in *Marine Bank* were not mere passive investors who placed capital in the hands of managers. It noted that "the [contractual] provision that the [purchasers] could veto future loans gave them a measure of control over the operation of the slaughterhouse not characteristic of a security." *Id.* at 560. Accordingly, "this unique agreement, negotiated one-on-one by the parties, is not a security." *Ibid.*

b. The relevance of *Marine Bank* in present circumstances is apparent. Here, as in *Marine Bank*, it is essential to look beyond the language of the statutory definitions and to examine the transactional "context." That examination establishes that petitioner has ample protection for its financial rights without resort to federal court remedies under the securities laws. The contractual warranty provisions in the purchase agreement are enforceable under state law, not federal law.

In addition, this Court's conclusion that the business agreement in *Marine Bank* did not give rise to a security sale is

precisely applicable here. The agreement in *Marine Bank* provided for a partial transfer of business pursuant to a joint venture. The interest in the joint venture was not a security because the plaintiffs obtained a "veto" power over certain managerial decisions. In the present case, petitioner obtained not only some role in management — it obtained *all* managerial power. Moreover, in this case, as in *Marine Bank*, the privately negotiated agreement, calling for the transfer of assets and stock, was unaccompanied by any element of public distribution. It therefore follows that this "unique agreement, negotiated one-on-one by the parties," is beyond the scope of the securities laws. *Id.* at 560.

## II. The Legislative History Confirms That Congress Did Not Intend To Treat Privately Negotiated Sales Of Businesses As Securities Transactions

As this Court explained in *Forman, supra*, 421 U.S. at 849:

"The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors."

Indeed, the *only* relevant statutory objective expressed in the legislative history is protection of the financial interests of those who buy or sell investment instruments — *i.e.*, persons who earn profits from the managerial efforts of others. See Thompson, *The Shrinking Definition Of A Security, supra*, 57 N.Y.U.L. Rev. at 241: "The securities laws are meant to protect those who turn over their investments to third parties, not those who manage their investments themselves." As President Roosevelt stated in his message to the House of Representatives in March 1933: "What we seek is a return to a clearer understanding of the ancient truth that those who manage \* \* \* corporations and other agencies handling or using other people's money are trustees acting for others." 77 Cong. Rec. 937 (1933). Thus, the Securities Act of 1933 sought to protect public investors by

regulating fiduciaries who solicited their funds (H.R. Rep. No. 85, 73d Cong., 1st Sess. 5 (1933)):

"The character of civil liabilities imposed by this bill are described elsewhere. Their essential characteristic consists of a requirement that all those responsible for statements upon the face of which the public is solicited to invest its money shall be held to standards like those imposed by law upon a fiduciary."

See also *id.* at 9-10; S. Rep. No. 47, 73d Cong., 1st Sess. 5 (1933).

This exclusive focus on the plight of the passive investor, who must rely on fiduciaries to manage his capital, is evident in the words of Congressman Rayburn, a principal sponsor of the legislation (77 Cong. Rec. 2910, 2918 (1933)):

"We have, on the one hand, 18,000,000 passive citizens having no actual contact with their companies; on the other hand, a few hundred powerful managers directing and controlling the destinies of the companies and the physical properties which they own. The owners of these symbols are entitled to know what the symbols represent. Those who are interested in purchasing these pieces of paper have the right to demand information as to the actual condition of the issuing company. Up to this time such information has depended on the grace of an entrenched management. These managers are truly trustees."

Moreover, Congressman Rayburn left no doubt about his understanding of the "ordinary concept of a security" (*id.* at 2917):

"Today the owner does not possess actual physical properties but he holds a piece of paper which represents certain rights and expectations. [T]he owners of these pieces of paper have little control over the physical property; the owners of these pieces of paper carry no actual responsibility with respect to the enterprise or its physical property."

Thus, Congress sought to remedy problems resulting from the separation of ownership and management — not the purported problems of those who both manage and own.

The legislative history of the Securities Exchange Act of 1934 shows the same concern for the plight of the dependent investor. Congress intended to "regulate the stock exchanges and the relationship of the investing public to corporations which invite public investment." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 2 (1934); accord, S. Rep. No. 792, 73d Cong., 2d Sess. 5 (1934). See also H.R. Rep. No. 1383, *supra*, at 4-5:

"When corporations were small, when their managers were intimately acquainted with their owners and when the interests of management and ownership were substantially identical, conditions did not require the regulation of securities marke[t]s. \* \* \* [A]s management became divorced from ownership and came under the control of banking groups, men forgot that they were dealing with the savings of men and the making of profits became an impersonal thing."

Thus, as a "complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests \* \* \*, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position" (*id.* at 5).

In short, the legislative history distinguishes clearly between passive investors and managers, and identifies the former as the "protected class." *Sutter v. Groen*, 687 F.2d 197, 201 (7th Cir. 1982):

"The Committee's report contains a chorus of references to 'disastrous results to investors,' 'tremendous losses to the investing public,' 'losses incurred in speculative transactions,' 'severe financial losses sustained by investors,' 'the exploitation of the investor,' and on and on in this vein. \* \* \* No other protected class is mentioned; entrepreneurs are not mentioned."



There is not the slightest hint in the legislative history that Congress intended to bring into federal court the claims of businessmen who acquire entire corporations through privately negotiated transactions, who wield substantial bargaining power to demand disclosure of relevant information, and who prescribe by contract specific remedies for the protection of their economic interests. Such an expansion of the scope of the federal securities laws—with an accompanying displacement of contractual remedies—would clash with Congress' stated purpose "to protect the public with the least possible interference to honest business." H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933).

This is not to say that only individual investors, and not business firms, may invoke the federal securities laws. Business firms frequently make investments, and when they do—whether they invest in securities traded on exchanges, over the counter, or in face-to-face transactions—they may claim the protection of the securities laws. See *United States v. Naftalin*, 441 U.S. 768 (1979). Common examples of such investments include stock transactions by brokerage houses, or purchases of debt securities by business firms seeking a return on surplus cash. However, when either a natural person or a business firm acquires all of the stock of a corporation by negotiated sale, not for investment but as a means to obtain ownership and control of the underlying physical assets, the transaction is commercial in nature and beyond the purview of the federal securities laws.

### III. The Ninth Circuit's Decision Finds Direct Support In The Established Principle That Sales Of General Partnership Interests And Commercial Notes Do Not Constitute Securities Transactions

The decision of the Ninth Circuit finds direct and compelling support in the law which governs other closely-related types of economic transactions. For example, this Court has

recognized that a joint venture involving shared profits and managerial responsibility is not a security, despite the literal applicability of the statutory definition. See *Marine Bank, supra*, 455 U.S. at 559-560. The reason is that the purchaser of the joint venture interest has "a measure of control over the operation of the [business enterprise] not characteristic of a security." *Ibid*.

The lower federal courts consistently have applied that principle to hold that sales of general partnership interests, which grant the purchaser a share of profits and some measure of control over the business enterprise, are beyond the scope of the federal securities laws. See, e.g., *Odom v. Slavik*, 703 F.2d 212, 215-216 (6th Cir. 1983) ("The managerial powers vested in general partners and the express right of inspection of documents gives them the kind of leverage and ability to protect themselves that takes them outside of the intended scope of the '34 Act"); *Williamson v. Tucker*, 645 F.2d 404, 417-425 (5th Cir. 1981); *Goodwin v. Elkins & Co.*, 730 F.2d 99, 102-108 (3d Cir. 1984).

The interests of general partners frequently are obtained by making capital contributions and also are assignable for value. See J. Crane & A. Bromberg, *Law of Partnership*, 130-131, 239-240 (1968). Nonetheless, the securities laws do not apply because "[p]artners are not passive investors who place money in an enterprise with the expectation of deriving profits solely from the efforts of others \* \* \*. Rather, they expect to reap profits through their own active participation in the control and management of the business." R. Jennings & H. Marsh, *Securities Regulation* 308 (3d ed. 1972).

This rationale, which distinguishes general partners from investors, applies *a fortiori* to entrepreneurs who purchase a business enterprise for themselves and operate it unilaterally. To treat general partners and entrepreneurs differently would create a serious anomaly under the federal securities laws and would blink at economic reality.



It also is well established that instruments which are securities when offered in an investment context cease to be securities when transferred in a commercial context. In particular, this Court has recognized that an "unsecured note, the terms of which were negotiated face-to-face, given to a bank in return for a business loan, is not a security." *Marine Bank, supra*, 455 U.S. at 560 n. 10; accord, *Forman, supra*, 421 U.S. at 849 n. 14 (citing with approval *C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc.*, 508 F.2d 1354 (7th Cir. 1974)). The lower courts are in agreement on this issue. See, e.g., *AMFAC Corp. v. Arizona Mall of Tempe*, 583 F.2d 426, 433 (9th Cir. 1978); *American Bank & Trust Co. v. Wallace*, 702 F.2d 93, 96-97 (6th Cir. 1983); *Chemical Bank v. Arthur Andersen*, 726 F.2d 930, 938-939 (2d Cir. 1984).

"Notes," of course, are securities embraced by the literal terms of the statutory definition when sold in an investment context. However, they cease to be securities when transferred in a face-to-face, privately-negotiated commercial transaction. This principle strongly supports the sale of business doctrine. As the court of appeals explained (Pet. App. 8a-9a): "We see no principled way to justify an analysis in which we determine whether a note is a 'security' within the meaning of the Acts by examining the transaction in light of the statutory purpose, but determine whether stock is a 'security' by examining only the instrument and not the transaction \* \* \*. We therefore conclude that adherence to the principle of construction adopted in our 'note' cases requires adherence to the 'sale-of-business' exclusion from the Securities Acts of the purchase of 100% of the stock of [a] closely-held corporation." Stock certificates, like notes, take countless forms and are transferred in many different contexts. There is no reasonable basis for applying different legal principles to them under the same statutory definition.

In this case, both individually-negotiated promissory notes and unregistered shares of stock changed hands in the same sale of business (J. App. 206-207). Nobody would seriously

contend that the "notes" in this transaction were "securities" merely because they fell within the literal terms of the statutory definition. And it is equally unreasonable, in the context of this purely commercial transaction, to so designate the shares of stock, or to seize upon the label affixed to them as a pretext for bootstrapping this state-law controversy into federal court.

#### IV. The Ninth Circuit's Decision Finds Direct Support In This Court's Repeated Pronouncement That The Federal Securities Laws Should Not Be Construed Broadly To Supersede Traditional State Law Remedies

The parties to the sale of business contract in this case specifically tailored their agreement to include warranties and covenants prescribing their respective rights, which were enforceable under state contract law. The very same claims now asserted by petitioner in federal court also have been asserted in a pending state law complaint.<sup>3</sup> Such claims traditionally have been relegated to state tribunals, and there is no good reason why federal courts should hear such cases and permit a totally unnecessary expansion of federal jurisdiction.<sup>4</sup>

<sup>3</sup> In this context, as in *Forman*, after-the-fact claims of "reliance" on the federal securities laws are wholly unavailing. A party which negotiates an agreement that prescribes detailed and comprehensive contract remedies should not later be heard to argue that it was led "justifiably to assume" that the federal securities laws would govern those same disputes. *Forman, supra*, 421 U.S. at 850.

<sup>4</sup> State law remedies, including remedies based upon contract and deceit, are specifically adapted and fully adequate to protect the purchaser of a business enterprise, who can quickly identify defects in assets or financial condition and invoke governing warranties and covenants after obtaining control of the business. See page ii, *supra*. See also *SEC v. Capital Gains Bureau, Inc.*, 375 U.S. 180, 194-195 (1963), observing that common law "doctrines of fraud and deceit" are specifically adapted to controversies concerning "tangible items of wealth," as opposed to "such intangibles as \* \* \* securities."

The availability of adequate state law remedies is an additional and compelling reason for declining to adopt the expansive construction urged by petitioner. See *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-480 (1977) (declining to "bring within [the securities laws] a wide variety of corporate conduct traditionally left to state regulation"). *Green* held that undue "extension of the federal securities laws would overlap and quite possibly interfere with state corporate law," and observed that "[a]bsent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities \* \* \*." *Green* explicitly declined to extend the federal securities laws "to 'cover the corporate universe.'" *Id.* at 479-480. Accord, *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 40-41 (1977); *Forman, supra*, 421 U.S. at 859 n. 26; *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 738 n. 9 (1975).<sup>5</sup>

As this Court admonished in *Marine Bank, supra*, it is essential to bear in mind that Congress "did not intend to provide a broad federal remedy for all fraud." 455 U.S. at 556. That admonition is relevant here, and weighs heavily against creation of a new federal remedy that could serve "no general purpose." *Daniel, supra*, 439 U.S. at 570.

#### V. The Sale of Business Doctrine Prevents Parties From Breaching Their Contractual Obligations And Deters Vexatious Litigation

In resolving the question of interpretation presented in this case, the Court should bear in mind the motivation for resorting to securities litigation in sale of business controversies. The

<sup>5</sup> The state law principles applicable to a sale of business controversy place a burden of proving reasonable care on purchasers alleging deception and give full effect to contractual remedies and limitations on liability. See *Grumman Allied Industries, Inc. v. Rohr Industries, Inc.*, 748 F.2d 729, 730-740 (2d Cir. 1984). A federal securities law remedy would run roughshod over these established state law principles, as discussed immediately below.

securities laws are invoked because they confer a very substantial advantage on the plaintiff. As this Court observed in *Wilko v. Swan*, 346 U.S. 427, 435 (1953), "the Securities Act was drafted with an eye to the disadvantages under which buyers labor." This Court's decisions have accordingly construed the securities laws liberally to minimize procedural and substantive burdens recognized at common law. See, e.g., *Herman & MacLean v. Huddleston*, No. 81-680 (Jan. 24, 1983), slip op. 13. The quest for liberal remedies is evident in petitioner's reliance on Section 12(2), 15 U.S.C. 77l (2), of the Securities Act of 1933. That provision permits the plaintiff to argue that the burden of proof should be shifted from the plaintiff to the defendant, who must establish that any omitted fact could not have been discovered and disclosed through the exercise of reasonable care. Compare note 5, *supra*.

While it is reasonable to suppose that Congress intended to grant these liberal remedies to investors to overcome the "disadvantages" described in *Wilko*, there is no reason to suppose that Congress wished to favor one side rather than another in a sale of business transaction. Certainly, wealthy businessmen and sophisticated lawyers purchasing a corporation have no claim to special protection when compared to the proprietors of a family-owned sawmill. In a case such as this, each side of the controversy is in a position to bargain effectively, and each side is free to contract—with the aid of counsel—to secure precisely the protection which it requires.

Conferring special substantive and procedural advantages on one party in a sale of business controversy is an invitation to serious abuse. As this Court emphasized in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739-743 (1975), "[t]here has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness \* \* \*. [I]n the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff



out of any proportion to its prospect of success \*\*\*. The very pendency of the law suit may frustrate or delay normal business activity \* \* \*." The *in terrorem* threat of burdensome litigation in federal court, with extensive discovery and only a limited possibility of resolution by summary judgment, gives the plaintiff substantial leverage to coerce a settlement and thereby reduce the purchase price. See pages i-iv, *supra*.

Federal court litigation under the securities laws permits the plaintiff to ignore the sale contract, with its specific covenants, warranties, procedures, and designation of governing law. See Add., *infra*, at A-6 to A-24. It permits the plaintiff to allege a host of "nondisclosures" after obtaining possession of the business, and to contend that each such omitted fact constituted a fraud, notwithstanding its own failure to carefully investigate. In every commercial transaction of this magnitude and complexity, it is possible to find some fact concerning the operation of the transferred business which was not "disclosed," particularly when the purchaser bargains for and receives only certain information during its due diligence investigation. Such a claim of nondisclosure permits the plaintiff to insist upon a trial by jury to resolve factual issues of "materiality" and "scienter," while effectively nullifying covenants providing that only specific warranties and representations are "of the essence." See Add., *infra*, at A-23.

Recognition of a securities action in this context invites other abuses. A liberal remedy in federal court encourages the purchaser to over-extend itself in a leveraged acquisition, to operate the newly-acquired company at great risk, and, if the company does not prove to be profitable or if interest payments cannot be met, to demand either a reduction in the purchase price or rescission. See pages i-iv, *supra*; see also *Condux v. Neldon*, 404 N.E.2d 523, 526, 530-531 (Ill. App. 1980), which applied this Court's decision in *Forman* and adopted the sale of business doctrine:

"The rights the plaintiffs claim would be manifestly open to abuse. A buyer, once in control of the corporation, would find it to his advantage to gamble with it, to take abnormal risks, knowing that any profits will be his while any losses can be unloaded onto the seller. The buyer would have an incentive to manage his business imprudently; the helpless seller, who thought he was disposing of his business, would find himself indefinitely dependent on its fortunes, now at the mercy of a buyer of unknown skill and honesty, over whom the seller has no control. The seller, in fact, would be in the sort of position the securities laws attempt to protect buyers against. \* \* \* \*". The [securities] laws, we reiterate, are a shield between the promoter and the sucker, not a sword with which the merely unskillful or unlucky businessman may oppress his predecessors."

Perhaps the most oppressive and unfair tactic which the sale of business doctrine serves to prevent is the tactic of renouncing an express agreement to arbitrate. Complex sale of business controversies are ideally suited for arbitration. See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). However, to the extent that a purchaser or seller in a sale of business controversy files suit under the federal securities laws, the unscrupulous plaintiff can contend (as in the *Algeran* case) that the arbitration agreement is a nullity. See *Wilko v. Swan*, *supra*, 346 U.S. at 438. See also pages i-iv, *supra*; Add., *infra*, at A-2 to A-3, A-23 to A-24.

It is no exaggeration to say that superimposing conflicting securities law remedies upon contractual remedies negotiated by the parties is a frontal assault on the principle of freedom of contract which long has been applied to dealings between sophisticated businessmen of equal bargaining power. Such a result cannot be reconciled with this Court's repeated declaration that the securities laws should not be broadly construed to permit "vexatious" litigation (*Blue Chip Stamps*, *supra*, 421 U.S. at 739). See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214-215 n. 33 (1976) ("the inexorable broadening of the class



of plaintiffs who may sue in this area" may "ultimately result in more harm than good").

#### VI. No Persuasive Policy Argument Has Been Advanced For Rejecting The Sale Of Business Doctrine

The SEC, in a series of *amicus curiae* briefs filed in the lower courts, has campaigned against the sale of business doctrine and it has now taken the same position in this Court. The SEC's arguments, which conflict with arguments previously presented by the SEC to this Court, are devoid of merit and should be rejected.<sup>6</sup>

<sup>6</sup> The SEC's arguments conflict with arguments previously presented to this Court in its *amicus* brief in *Marine Bank v. Weaver*, No. 80-1562, at 8-10, 18-19, 25-26, and 26-29. In that brief, the SEC conceded that both a certificate of deposit and a profit sharing agreement were beyond the scope of the securities laws, despite the literal applicability of the statutory definitions. The SEC acknowledged that it is necessary to look beyond the definitional language "in those cases in which there is evidence that transactions of the type at issue were not intended to come within the scope of the statute" (*id.* at 10 n. 11); that the term "security" must be construed in light of Congress' intent to avoid regulating those "types of securities and securities transactions where there is no practical need for [the statute's] application or where the public benefits are too remote" (*id.* at 26); that the analysis of economic "context" required by the securities laws includes "the surrounding factual circumstances" (*id.* at 8); that "[i]t was the interest of investors [as opposed to parties to commercial contracts] that required special protection under the securities laws" (*id.* at 18); and that Congressional intent to exclude a controversy from the scope of the securities laws could be inferred from Congress' recognition that persons in the position of the plaintiff, on the one hand, and "investors," on the other, were properly "viewed as standing in fundamentally different positions" (*id.* at 18). As demonstrated in this brief, application of those principles—previously endorsed by the SEC—leads inescapably to the conclusion that the court below correctly adopted the sale of business doctrine. The SEC's abandonment of those principles in this litigation removes any presumption in favor of its proffered interpretation. See *Forman*, *supra*, 421 U.S. at 858-859 n. 25; *Daniel*, *supra*, 439 U.S. at 566 n. 20.

The Commission's principal policy argument (Br. 21-24) is that the sale of business doctrine should be rejected because it will precipitate the judiciary down a "slippery slope." If sales of 100% of a company's stock are not covered by the securities laws, how will the judiciary grapple with cases involving sales of 75% or 51%? The short and sufficient answer to that argument is that the present case—involving a 100% stock sale accompanied by an unlimited transfer of control—involves no such complexities. The present case calls for a decision on its own record.<sup>7</sup>

Beyond this, federal courts which have implemented this Court's "economic realities" test have experienced no difficulty in applying it in other contexts. Thus, they have faithfully adhered to the principle that "[e]ach transaction must be analyzed and evaluated on the basis of . . . the factual setting as a whole." *Marine Bank*, *supra*, 455 U.S. at 560 n. 11. Where, as an objective matter, a purchaser negotiates for the acquisition of a majority of the stock of a corporation in a private transaction, installs a majority of the board of directors, and proceeds to earn profits by guiding the operations of the acquired corporation, the "economic realities" test properly is applied to preclude federal court jurisdiction. See Easley, *Recent Developments in the Sale of Business Doctrine*, 39 *Business Lawyer* 929, 951-953, 966-975 (1984).

Judge Posner's explanation of the practical aspects of applying the "economic realities" test in such a case, as set forth in *Sutter v. Groen*, 687 F.2d 197, 202 (7th Cir. 1982), is

<sup>7</sup> References to other cases involving their own economic circumstances, which may or may not be governed by the Court's decision here, are not a valid basis for extending the federal securities laws in this case far beyond the intent of Congress. Moreover, a decision from this Court holding that private sales of all identifiable stock of a corporation are beyond the scope of the securities laws could be applied by the lower federal courts with efficiency and would mitigate their already excessive workload. See pages i-iv, *supra*; see also Add., *infra*, at A-1 to A-3.

especially pertinent: "We agree that the costs of administering legal rules are a proper concern \* \* \*. But rarely will a net saving in those costs be produced by expanding liability since even if the legal standard will be simpler and therefore cheaper to apply in each case, the number of potential cases in which it will be applied will be greater." Judge Posner added that even if a rigid and literal approach to the definitional issue offered "some net cost savings, we doubt they could justify expanding liability to reach substantive evils far outside the scope of the legislature's concern." *Ibid.*<sup>8</sup>

The legal issues raised in a sale of business case are no more complex than those raised in the many other cases cited by the SEC (Br. 18 n. 18), which also require an examination of economic realities. The controlling principle in all such cases is the same as that which governs here: the securities laws apply when the plaintiff places money in the hands of others with the expectation of profit deriving from their managerial efforts; they do not apply when the substance of the transaction is an outright acquisition of economic resources to be managed by the plaintiff himself.

We also submit that there is no merit to the SEC's suggestion (Br. 8-10) that acceptance of the "economic realities" test in cases such as this reduces all types of securities to "investment contracts," which originally were analyzed under that standard. It is a *non sequitur* to argue that because all types of securities described in the statutory definition are recognized to have a common economic characteristic — investment of money in a joint enterprise with profits stemming from the efforts of others — that differences between distinct types of securities are therefore eliminated. Under the econom-

<sup>8</sup> Courts which accept the sale of business doctrine properly have declined to extend it to transfers of control involving widespread solicitation of public investors. See *McGrath v. Zenith Radio Corp.*, 651 F.2d 458, 467-468 n. 5 (7th Cir. 1981). Such transactions, in contrast to the transaction at issue in the present case, clearly do implicate "the legislature's concern." See pages 14-18, *supra*.

ic realities test, each type of security retains its special attributes (e.g., stocks are equity investments, bonds are secured debt investments, notes are unsecured debt investments, etc.) even though every security has a common economic feature. Accordingly, this Court need not hesitate to accept the sale of business doctrine based on the erroneous assertion that such a ruling would blur traditional differences between the categories of securities enumerated by Congress.

The SEC also argues (Br. 12-13) that, because Congress did not expressly state that privately negotiated transfers of 100% of a company's stock are beyond the scope of the securities laws, federal courts are powerless to examine the economic realities of such transactions. This argument ignores Congress' unambiguous declaration that the securities laws should not be applied literally if the "context" indicates otherwise. In *Marine Bank*, this Court held that the statutory language refers to economic context, and not merely statutory context. 455 U.S. at 555-560. In so holding, the Court followed the SEC's brief *amicus curiae*, which argued that "[t]he word 'context,' which Congress deliberately selected, refers to the surrounding factual circumstances" (No. 80-1562 Amicus Br. at 8). As the SEC explained, "[i]f \* \* \* the context of a given transaction so requires, a literal application of the statutory definition should be subordinated to Congress' underlying intent. Effectuation of the intention of the legislature remains the touchstone" (*id.* at 9-10). Thus, a careful contextual analysis, which includes "the interrelated conditions in which something \* \* \* occurs" (*id.* at 8 n. 8), is essential because "a thing may be within the letter of the statute and yet not within the statute, because not within its spirit \* \* \*" (*id.* at 9).

The very purpose of this contextual approach is to avoid a wooden construction that would extend the securities laws beyond Congress' intent and upset "the balance between state and federal responsibility." *Forman, supra*, 421 U.S. at 859 n. 26. This Court's recent decisions establish that rigid literalism is



not appropriate in cases involving a "stock certificate" (*Forman*), or a "long-term debt obligation," "investment contract," or "certificate of \* \* \* participation in any profit-sharing agreement" (*Marine Bank*). In such instances, the Court uniformly has required a analysis of economic reality. There is no ground for departing from that standard here.

To be sure, "[t]here may be occasions when the use of traditional names such as 'stocks' or 'bonds' will lead a purchaser justifiably to assume that the federal securities laws apply." *Forman, supra*, 421 U.S. at 850. But this will follow only if "the underlying transaction" embodies the economic substance of a securities transaction. *Id.* at 851. Such an assumption plainly is not justifiable when a sophisticated purchaser negotiates for the acquisition of an entire business, and bargains for and obtains specific covenants and warranties to protect its financial interest under state law. In such a situation, the justifiable expectation of both parties is that the comprehensive sale agreement, enforceable under state law, prescribes the rights and remedies of the parties. To permit one party to cast aside that negotiated contract by resort to securities litigation in federal court would seriously undermine the principle of freedom of contract—a principle which is of paramount importance in dealings between sophisticated businessmen and which Congress did not intend to disturb.

### CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted.

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## **ADDENDUM**

UNITED STATES DISTRICT COURT

Central District of California

ALGERAN, INC.,

*Plaintiff,*

v.

ADVANCE ROSS CORP., et al.,

*Defendants.*

The Court, having heard argument from counsel on April 30, 1984, with respect to defendants' motion for reconsideration, and having considered the points and authorities and declarations submitted therewith,

HEREBY ORDERS that pursuant to Local Rule 7.16(a) this is a proper motion for reconsideration as there is now a material difference in law which did not exist at the time this Court considered the original motion to dismiss. In reconsidering the motion, the Court regards it as a motion for summary judgment as there are matters outside of the pleadings which have been submitted and considered by the Court.

After considering the Ninth Circuit's recent decision in *Landreth Timber Co. v. Landreth*, \_\_\_ F.2d \_\_\_ (March 7, 1984) the Court grants summary judgment in favor of defendants as to Counts I-IV. Although plaintiff and counter-defendants argue that material questions of fact exist which preclude summary judgment, the Court disagrees. The Court finds that plaintiff's purchase of AMI was not a mere passive investment and the plaintiffs were not so dependent upon the existing AMI management for their profits that they could not replace it or exercise ultimate control. *See Gordon v. Terry*, 684 F.2d 736 (11th Cir. 1982), *reh'g. denied*, 690 F.2d 907, *cert. denied*, \_\_\_ U.S. \_\_\_ (1983).

The Court finds that Algeran, Inc., purchased AMI's existing management when it purchased AMI, and Advance

Ross Corp. had no control over AMI or its management after the sale.

In denying the original motion to dismiss, the Court ruled that as a matter of law the sale-of-business doctrine did not apply in this Circuit. Since then, however, the Ninth Circuit has adopted the doctrine in the *Landreth* case. The Court believes that the application of *Landreth* to the undisputed facts of this case requires summary judgment in favor of the defendants as to the federal securities claims. Pursuant to *Hamilton Jewelers v. Department of Corporation*, 37 Cal. App. 3d 330 (1974), the Court grants summary judgment in favor of defendants as to the state securities claims.

The Court finds that the notes issued to defendants by plaintiffs are not securities because they do not represent a contribution of "risk capital subject to the entrepreneurial efforts of others." *Amfac Manufacturing Corp. v. Arizona Mall of Tempe*, 583 F.2d 426, 432 (9th Cir. 1978).

The Court rejects plaintiff's claim that because it is in bankruptcy it cannot be compelled to arbitrate its claims. This is not the case in which a plaintiff/creditor is seeking to recover a judgment from a defendant/debtor. Here, Algeran, Inc. is the plaintiff seeking to rescind an agreement it entered into. Defendants are simply defending on the claims. The Court believes it would be manifestly unfair to allow plaintiff to use the bankruptcy system as a shield but at the same time permit it to use the federal courts as a sword. Plaintiff voluntarily chose to file suit in federal court and must therefore expect to suffer any possible adverse consequences by doing so. The Court believes that *Johnson v. England*, 356 F.2d 44 (9th Cir. 1966) and *Braniff Airways, Inc. v. United Airlines, Inc.* (In re Braniff Airways, Inc.) 33 Bankr. 33 (Bankr. N.D. Tex. 1983) do not compel a different result.

The Court further finds that defendants have not waived their right to arbitration either because of filing a suit in Illinois

or in having undertaken some discovery. The Court further believes that plaintiff and counterdefendants' argument that any possible stay will result in unnecessary delay, procedural confusion and potential inconsistent results is incorrect. On the contrary, the Court believes that arbitration may well be the speediest method of resolving the claims in this case.

The Court orders that the remaining claims in the complaint as well as other claims, i.e., counterclaims, be stayed pending arbitration of the non-security claims in the complaint, i.e., Counts V-VII. The Court believes that ¶8.04 of the Agreement requires that these claims be arbitrated. The Court reads ¶ 8.04 in conjunction with ¶s 8.02 and 2.25 and concludes that plaintiff's claims are disputes and controversies relating to the interpretation of the contract. See *Mediterranean Enterprises, Inc. v. Sangyong Corp.*, 708 F.2d 1458 (9th Cir. 1983).

As to the argument that there is an \$800,000.00 limit of recovery in the Agreement, the Court leaves it to the arbitrator to interpret the Agreement.

IT IS FURTHER ORDERED that this case is removed from the Court's active caseload until further application by the parties or Order of this Court.

IT IS FURTHER ORDERED that counsel are to file a joint status report on a quarterly basis beginning on October 1, 1984.

IT IS FURTHER ORDERED that defendants shall file proposed Findings of Fact and Conclusions of Law and a Judgment by May 29, 1984.

DATED: This 15th day of May, 1984.

/s/ DAVID V. KENYON  
David V. Kenyon  
United States District Judge



## [EXCERPTS FROM]

## AGREEMENT FOR SALE OF STOCK

This AGREEMENT FOR SALE OF STOCK is made and entered into as of the 15th day of December, 1982, by and between ADVANCE ROSS CORPORATION, a Delaware corporation, its wholly owned subsidiary, AD ROSS CORPORATION, a Delaware corporation (collectively referred to herein as "Seller"), and ALGERAN, INC., a California corporation ("Buyer"), with respect to Seller's shares of stock in AMI INDUSTRIES, INC., a Colorado corporation ("Company").

WHEREAS, Seller owns 406,786 shares (the "Shares") of the Company's \$0.50 par value Common Stock, representing 96.637 percent of the issued and outstanding shares of stock in the Company, and

WHEREAS, Seller desires to sell, and Buyer desires to purchase all of Seller's Shares,

IT IS HEREBY AGREED:

## ARTICLE I

## AGREEMENT OF SALE AND PURCHASE

1.01 *Sale of Stock.* Seller agrees to sell and Buyer agrees to purchase all of the Shares, as provided in this Agreement.

1.02 *Purchase Price.* In consideration for the sale of the Shares, Buyer agrees to pay to Seller the sum of \$8,000,000.00 (the "purchase price"). The purchase price was negotiated on the basis of (a) total stockholder's investment in the Company as of June 30, 1982, as reflected in the Company's June 30, 1982 consolidating balance sheet with Seller, plus (b) the amount of the long-term debt owed by the Company to Seller as of the June 30, 1982 consolidating balance sheet with Seller, less (c) the current and long-term notes receivable from

Regent/Pearne. The total of the foregoing amounts on June 30, 1982 was \$7,081,612.

1.03 *Payment of Purchase Price.* The purchase price shall be paid in the following manner:

(a) At the Closing (as defined in Section 4.01 below) Buyer shall pay the sum of \$5,300,000.00

\* \* \*

(b) At the Closing, Buyer shall deliver four promissory notes (the "Notes"), executed by Buyer as maker and payable to Seller or order. The Notes shall be in the following principal amounts and maturity dates:

(i) \$200,000.00 due one year after the Closing Date;

(ii) \$350,000.00 due two years after the Closing Date;

(iii) \$600,000.00 due three years after the Closing Date; and

(iv) \$1,550,000.00 due four years after the Closing Date.

\* \* \*

1.04 *The Notes.* Each of the Notes shall bear interest on the unpaid principal balance at twelve percent (12%) per annum, payable quarterly.

\* \* \*

1.05 *Security for the Notes.* Payment of the Notes will be secured pursuant to a Security and Pledge Agreement providing, among other things, \* \* \* (i) that the security shall consist of an assignment of Buyer's interest in and to the oil and gas revenues of its wholly-owned subsidiary, Algeran-Savage Corporation (subordinate only to the rights of Union Bank) and a pledge of the [AMI] Shares.

\* \* \*

## ARTICLE II

## WARRANTIES OF SELLER

Seller does hereby warrant and represent to Buyer as follows:

2.01 *Due Organization of the Company.* The Company is and will be at the Closing Date a corporation duly incorporated and validly existing under the laws of the State of Colorado; is and will be at the Closing Date in good standing under the laws of the State of Colorado; is not and will not as of the Closing Date be required to be qualified to do business in any other state or jurisdiction where the failure to be qualified would result in a liability for the Company in excess of \$10,000.00; has neither property nor employees in any state other than Colorado, except as described by name or other specific description and address in SCHEDULE 2.01; has and will have at the Closing Date all requisite corporate power and authority to own its properties and carry on its business as now conducted; and has and will have at the Closing Date received no notice that it has not obtained all licenses, permits, or other authorizations, nor failed to take any actions, required by applicable law or governmental regulations in connection with its business as now conducted.

2.02 *Validity of Agreement.* The execution and delivery of this Agreement and consummation of the transactions contemplated hereby will not violate any provision of any Articles of Incorporation, By-Laws, agreement, mortgage, lien, lease, instrument, order, judgment or decree to which the Seller or the Company are a party or by which either of said entities are bound, and shall not violate any other restriction of any kind or character to which either of said entities are subject.

2.03 *Financial Statements.* Seller has delivered to Buyer (a) Seller's annual report for its year ended December 31, 1981; (b) Seller's unaudited first quarter report for the period

ended March 31, 1982; and (c) the Company's unaudited financial statements, including, among others, consolidating balance sheet and consolidating statements of income for the months ended June 30, 1982, July 31, 1982, August 31, 1982, September 30, 1982 and October 31, 1982. A true and correct copy of the Company's consolidating balance sheet for the month ended June 30, 1982 is attached hereto as SCHEDULE 2.03. All of the foregoing financial statements present fairly for purposes of consolidation with Advance Ross Corporation's financial statements the financial condition of the Company on the dates thereof and the results of operations for said periods, in conformity with generally accepted accounting principles applied on a consistent basis, except (i) for the change in 1980 to the method of determining inventory costs as described in Note B to the consolidated financial statements of Advance Ross Corporation for the year ended December 31, 1981; and (ii) that they do not give effect to certain adjustments and reclassifications that will be made in the audited financial statements of the Company referred to in Section 5.01(a) of this Agreement. The adjustments and reclassifications referred to in the foregoing clause (ii) will not reduce the Company's total stockholder's investment as shown in the Company's June 30, 1982 financial statements. As of the Closing Date, the amount of the Company's total stockholder's investment plus current and long term debts to Seller, less the current and long term notes receivable from Regent/Pearne will total no less than that shown on the June 30, 1982 financial statements except that changes in the principal amount of intercompany debt will be reflected in adjustments to the Note provided for in Section 1.03(b)(iv).

2.04 *Patents, Copyrights, Trademarks, Tradenames, Servicemarks, Licenses, and Manufacturing Processes.* The Company is the sole owner of the patents, patent applications, inventions, disclosures, copyrights, trademarks, tradenames and licenses listed and described in SCHEDULE 2.04. Except to



the extent, if any, set forth in SCHEDULE 2.04, such patents, patent applications, inventions, disclosures, copyrights, trademarks, tradenames and licenses are valid and in good standing, are subject to no liens or charges and are not involved in any interference, opposition or cancellation proceedings.

• • •

**2.05 Real Property.** SCHEDULE 2.05 contains a list of all real property owned by the Company or in which the Company has a leasehold or other interest. Such Schedule also contains a substantially accurate legal description of all such real property, and a description of all claims, liens and encumbrances against the Company's interest in all such real property.

**2.06 Title to Properties.** The Company has good marketable title to its properties and assets free and clear of all claims, liens, and encumbrances except for those matters which are disclosed in SCHEDULE 2.06.

**2.07 Tax Returns.** The Company, either alone or in conjunction with the filing of consolidated tax returns with Seller, has timely filed or caused to be filed, and has paid or accrued all taxes which have become due pursuant to such returns, all federal, state and local tax returns for income taxes, franchise taxes, sales and use taxes, withholding and all payroll taxes, property taxes, and all other taxes of every kind whatsoever required by law to have been filed, and all such tax returns are complete and accurate. For the purpose of the preceding sentence, a return shall be deemed to be timely filed if it is filed after the due date within any period allowed in an extension granted by the taxing authority. All of the Seller's and the Company's estimated tax deposits required to be paid prior to the Closing Date have been or will have been timely paid.

• • •

**2.08 Capitalization.** The Company is authorized to issue two classes of stock, consisting of 2,000,000 shares of common

stock having a par value of \$0.50 per share and 1,000,000 shares of preferred stock having a par value of \$1.00 per share. There are 420,944 common shares outstanding, and no more are presently issued and outstanding. No preferred shares have been issued. Seller owns, beneficially and of record, free and clear of all liens, charges, claims, equities, restrictions, or encumbrances 406,786 common shares, representing 96.637% of the outstanding and issued shares of the Company. There are no options or warrants outstanding to acquire any of the Shares nor any of the authorized but unissued shares of stock in the Company, and the Company is not subject to any agreement, express or implied, which would require it to issue any additional shares of stock. Seller has no knowledge indicating that any of the outstanding shares of the Company were not duly and validly issued in compliance with all applicable laws and regulations or that they are not fully paid and nonassessable. Seller has full right, power and authority to sell the Shares to Buyer as provided in this Agreement. Prior to Seller's acquisition of the Shares, the Company's shares were publicly traded and the Company was required to file reports pursuant to the Securities Exchange Act of 1934 (the "Act"), as amended. Seller has caused the Company to take such actions as were necessary to terminate the Company's reporting requirements under the Act, and the Company is not now and will not as of the Closing Date, be a reporting company under the Act.

**2.09 Litigation.** Except as set forth in SCHEDULE 2.09, neither Seller nor the Company has been served with any summons, complaint, or notice to arbitrate, and none of Seller's officers nor the Company's officers have any knowledge of any suit or action (equitable, legal or administrative), arbitration or other proceeding (including any formal or informal governmental investigation), pending or threatened in any way involving the Company or which relates to the Company's properties, business, assets, or prospects, or with respect to



which the Company, Seller, any of Seller's officers or any of the Company's officers has knowledge whereby as a result of the judgment or decision therein the Company may become legally obligated to discharge all or part of the judgment.

\* \* \*

**2.10 Buildings and Equipment.** All buildings and equipment used or occupied by the Company are in good repair and operating condition, and Seller has no knowledge indicating that any such buildings or equipment fail to conform with all applicable ordinances, regulations and zoning laws.

**2.11 Material Contracts.** Except as listed in SCHEDULE 2.11, the Company is not a party to any written or oral: (a) contract for the employment of any officer or individual employee; (b) contract for the purchase of materials, supplies, services, machinery, or equipment involving payment by the Company of more than \$10,000 in each case, or more than \$25,000 in the aggregate with any one contracting party; (c) contract continuing over a period of more than one year from the date hereof; (d) material contract not terminable on thirty (30) days' notice or less without liability on the part of the Company; (e) material distributor, sales agency, or advertising contract, or contract for the sale of its products or services; (f) lease; (g) material contract with any subcontractor; (h) stock purchase, stock option, hospitalization, insurance or similar plan or practice, formal or informal, in effect with respect to its employees or others; (i) consignment agreement; or (j) contract not made in the ordinary course of business. SCHEDULE 2.11 also contains a true and complete schedule of all other material contracts and agreements to which the Company is a party. For purposes of this section, the term "material contract" excludes purchase or sale contracts involving less than \$10,000.00, individually. True and complete copies of all contracts listed in SCHEDULE 2.11 requested by Buyer shall be delivered to Buyer upon demand.

\* \* \*

**2.12 Insurance Policies.** Attached hereto as SCHEDULE 2.12 is a list of the insurance policies and bonds owned by the Company.

**2.13 Liabilities.** The Company does not have any liabilities of a kind generally described on a balance sheet (including notes thereio) in accordance with generally accepted accounting principles, whether accrued, absolute, contingent, or otherwise, and whether due or to become due, known or unknown, except (a) Liabilities set forth on the October 31, 1982 financial statement and (b) Liabilities that have been incurred in the ordinary course of business of the Company since October 31, 1982; or (c) Liabilities disclosed on SCHEDULE 2.13.

**2.14 Power to Enter Into Agreement.** This Agreement has been approved by resolution of Seller's Board of Directors, and no remaining corporate action or third party action is required to make this Agreement binding upon Seller.

**2.15 Accounts Receivable.** The accounts receivable as shown on the October 31, 1982 financial statement and that will exist as of the Closing Date, have arisen, or will have arisen, out of materials furnished or services performed. Seller has no knowledge indicating that any such accounts receivable will not be collectible in full on or before November 30, 1983.

**2.16 Inventory.** The inventory on hand as of the Closing Date is not and will not be obsolete or unusable in any material respect as of the Closing Date, and is saleable in the ordinary course of the business of the Company, subject to the understanding that Buyer and Seller agree that a reserve of \$450,000.00 is adequate for all obsolete and unusable inventory that may be on hand as of the Closing Date. All finished goods comply with normal commercial standards in the rail and air line industries, as the case may be, and with all applicable laws,

rules and regulations pertaining to the Company's anticipated use of such finished goods.

#### 2.17 *Pension and Profit Sharing Plans.*

(a) *Hourly Employees Pension Plan.* The Company has heretofore established the AMI Industries Inc. Hourly Employees' Retirement Plan (the "Hourly Plan") for its hourly employees. Pursuant to the Hourly Plan, the Company has established a trust (the "Hourly Trust") with individual trustees, which trustees are the "contract holder" of a group annuity contract issued by Aetna Life Insurance Company, and the Company has transferred funds to the Hourly Trust for the purpose of funding benefits under the Hourly Plan. True and correct copies of the Hourly Plan and Hourly Trust as of the date hereof are attached hereto as SCHEDULE 2.17(a). Prior to the Closing Date, the Company shall have accrued contributions to the Hourly Trust through the Closing Date in accordance with the amounts described in the actuarial valuation report prepared by the Plan's actuaries, Reed-Ramsey, Inc., for the 1982 Plan Year.

\* \* \*

2.18 *Labor Problems.* Since December 31, 1976, the Company has never suffered a material work stoppage, and no work stoppage is presently threatened. Attached hereto as SCHEDULE 2.18(a) is a list of outstanding written labor grievances as of the date hereof and, as of the date hereof, there are no other material written labor grievances involving any labor unions representing any of the employees of the Company. Attached hereto as SCHEDULE 2.18(b) is a list of all labor organizations or associations of employees with which the Company has any written or oral contract with or commitments or liabilities to, along with a copy of any written contract and a statement describing any oral contract or commitment.

2.19 *Customers and Suppliers.* Attached hereto as SCHEDULE 2.19 is a list of (a) the ten largest customers of the

Company (in dollar volume for the fiscal year ended December 31, 1981 and for the current fiscal year through October 31, 1982); and (b) the ten largest suppliers of the Company (in dollar volume for the fiscal year ended December 31, 1981 and for the current fiscal year through October 31, 1982); and (c) any current sole-source supplier of significant goods or services to the business of the Company (other than electricity, gas, telephone or water) with respect to which their unavailability would at the Closing Date, have a material adverse effect upon the Company's business. Neither Seller nor the Company has any information or knowledge which indicate that any of the customers or suppliers listed in Schedule 2.19 will cease to do business with the Company or will reduce the volume of their business with the Company in a way which would have a material adverse effect upon the Company's business.

2.20 *Subsidiary Corporations.* Except as set forth on SCHEDULE 2.20, the Company does not own, directly or indirectly, any interest in any corporation, business trust, joint stock company, or other business organization or association. The Company is not a general partner of any partnership or a party to any joint venture.

2.21 *Dividends.* The Company has not since June 30, 1982 declared or paid or made any payment of a dividend or other distribution to its shareholders or purchased, redeemed, or otherwise acquired or disposed of any share of its stock; and the Company has not, except in the ordinary course of business or except as specifically permitted by this Agreement, paid or discharged any outstanding indebtedness.

2.22 *Closing Statements.* Seller shall deliver to the Buyer on or before the Closing a true and complete list, as of the date hereof and certified by the Company's chief financial officer, showing: (a) the names of all persons whose compensation for the Company for the fiscal year ending December 31, 1982 will equal or exceed \$35,000.00; (b) the name of each bank in



which the Company has an account or safe deposit box and the names and identification of all persons authorized to draw thereon or to have access thereto; and (c) the name of all persons, if any, holding tax or other powers of attorney from the Company and a summary statement of the terms thereof.

**2.23 Conduct of Company's Business Prior to Closing.** Between October 31, 1982 and the Closing Date, except with the prior written consent of Buyer, Seller shall have caused the Company: (a) To conduct its business only in the ordinary and usual course; (b) To not change the character of its business or undertake any new business; (c) To not enter into any employment contracts; (d) To not sell any of its assets except in the ordinary course of business and for good and sufficient consideration; (e) To not amend, terminate or change any material contracts listed in SCHEDULE 2.11; (f) To not sell or issue any stock, bonds or other securities or rights therein; (g) To not incur any obligation or liability except in the ordinary course of business; (h) To not make any payment to Seller, except to pay interest or principal on the intercorporate debt referred to at Section 1.03(a)(i), above or to pay the regular, periodic management fee as paid or accrued to the Closing Date; (i) To not mortgage, pledge or subject to lien or encumbrance any of its assets, tangible or intangible; (j) To not make any contribution or incur any indebtedness under the Hourly Plan, the Salaried Plan or the Thrift Plan except to the extent provided herein, and to not make any amendments to or changes in the Hourly Plan, Hourly Trust, Thrift Plan or Thrift Trust.

**2.24 Warranty of Product.** The Company has provided purchasers of its finished goods with various product warranties. Such warranties are individually negotiated, and the Company does not have any one form of warranty that has been provided with respect to more than ten percent of its sales in any calendar year, other than as described in SCHEDULE 2.24. The Company's financial statements present fully and fairly the Company's expenses and obligations related to

product warranties in conformity with generally accepted accounting principles applied on a consistent basis.

\* \* \*

### ARTICLE III

#### WARRANTIES OF BUYER

\* \* \*

### ARTICLE IV

#### CLOSING

**4.01 Time and Place of Closing.** This transaction shall close ("the Closing") at such location in Los Angeles County, California as Buyer shall designate, or, if Buyer consents, at such other location as Buyer and Seller shall mutually agree. The Closing shall take place on December 15, 1982 at 10:00 A.M. (the "Closing Date").

**4.02 Documents Delivered by Seller to Buyer at the Closing.** At the Closing, Seller shall deliver the following documents to Buyer:

(a) A stock certificate or certificates representing all of the Shares, duly endorsed for transfer to Buyer;

(b) The statement of Ernst & Whinney as required by Section 1.03(a)(i), above;

(c) Seller's written release of the Company from any debts or claims, including specifically the intercorporate debt, but excluding the Company's obligations with respect to corporate income taxes as provided in Section 2.07 above, whether accrued, absolute, contingent or otherwise, and whether due or to become due, known or unknown, in form and substance satisfactory to Buyer and its counsel;



(d) A certificate from the Secretary of State of the State of Colorado dated no earlier than November 30, 1982 that the Company is in good standing in such state;

(e) An opinion of Daniel P. Edwards, Esq. in form and substance satisfactory to buyer and its counsel to the effect that the warranties and representations contained in Sections 2.01, 2.02, 2.04, 2.05, 2.06, 2.08, 2.09, 2.11, 2.18, the last sentence of 2.19, 2.20 and 2.25 of this Agreement are true and correct to the best of said counsel's knowledge and further to the effect that: (a) the Company has been duly incorporated and is validly existing, in good standing, under the laws of the state of Colorado, has all requisite corporate power and authority to own its properties and carry on its business as conducted on the date of the Closing, and as of such date has all licenses, permits, or other authorizations, and has taken all actions required by applicable law or governmental regulations in connection with its business as then conducted; (b) the Company has authorized and outstanding capital stock as set forth in Paragraph 2.08 and all shares of its outstanding capital stock have been duly and validly authorized and issued and are fully paid and nonassessable; (c) except as may be set forth in SCHEDULE 2.09 hereof, such counsel does not know (after reasonable investigation) of any litigation, proceedings, or governmental investigation or labor dispute pending or threatened against or relating to the Company; (d) such counsel does not know or have reason to know (after reasonable investigation) that there are any defects in or encumbrances upon the title of the Company to its property and assets and leaseholds which would violate the representations in Article II of this Agreement; and (e) as to such other legal matters as Buyer may reasonably require.

(f) An opinion of Messrs. Mayer, Brown & Platt in form and substance satisfactory to Buyer and its counsel to the effect that the warranties and representations contained in Sections 2.02, 2.09, 2.14, and 2.17 of this Agreement as they pertain to Seller are true and correct to the best of said counsel's knowledge, and further to the effect that: (a) Seller has complete and unrestricted power under its Articles of Incorporation and By-Laws to sell, convey, assign, transfer, and deliver to Buyer the Shares to be sold by Seller under this agreement; (b) this Agreement is the valid and binding obligation of Seller and is enforceable against Seller in accordance with its terms and conditions, and will not conflict with, or result (immediately or upon the giving of notice and/or upon the passage of a period of time) in a breach of, any of the terms of any indenture, mortgage, deed of trust, or other agreement, instrument or understanding to which Seller is a party or by which it is or may be bound, or constitute a default thereunder, or result in the creation or imposition of any lien, charge, or encumbrance, or give to others any interest or right in the Shares or in any of the properties or other assets of the Company; and (c) as to such other legal matters as Buyer may reasonably require; and

(g) Such other documents as may otherwise be required by this Agreement.

4.03 *Documents to be Delivered by Buyer to Seller.* Buyer shall deliver or cause delivery of the following to Seller at the Closing:

- (a) The cash required by Section 1.03(a), above;
- (b) The Notes required by Section 1.03(b), above;
- (c) The Security and Pledge Agreement required by Section 1.05, above;
- (d) Assignments of Buyer's interest in and to the oil and gas revenues of Buyer's wholly-owned subsidiary,

Algeran-Savage corporation, subordinate to the rights of Union Bank, as security under the Security and Pledge Agreement;

(e) A stock certificate or certificates representing all of the Shares, with stock powers executed in blank, as security under the Security and Pledge Agreement; and

(f) An opinion of STERN & MILLER, a Professional Corporation, in form and substance satisfactory to Seller and its counsel to the effect that the warranties and representations contained in Sections 3.01 and 3.02 of this Agreement are true and correct to the best of said counsel's knowledge, and further to the effect that: (a) such counsel does not know (after reasonable investigation) of any litigation or proceeding pending or threatened against Buyer, except as set forth on SCHEDULE 3.04; (b) this Agreement is the valid and binding obligation of Buyer and is enforceable against Buyer in accordance with its terms and conditions, and will not conflict with, or result (immediately or upon the giving of notice and/or upon the passage of a period of time) in a breach of, any of the terms of any indenture, mortgage, deed of trust, or other agreement, instrument or understanding to which Buyer is a party or by which it is or may be bound, or constitute a default thereunder; and (c) as to such other legal matters as Seller may reasonably require.

## ARTICLE V

### ADDITIONAL COVENANTS OF SELLER

#### 5.01 *Books and Records—Cooperation and Assistance*

(a) *Preparation of Audited Financial Statements.* Seller's independent auditors, Ernst & Whinney (the "Auditors"), have examined and issued their opinion on Advance Ross Corporation's consolidated financial statements for each of the three

years in the period ended December 31, 1981 which include the financial statements of the Company. Within forty-five days after the Closing Date, Seller shall deliver to Buyer audited balance sheets of the Company as of December 31, 1980 and December 31, 1981 and statements of operation and changes in financial position for each of the three years in the period ended December 31, 1981 prepared in accordance with generally accepted accounting principles applied on a consistent basis except for the change, in 1980, in the method of determining inventory costs as described in Note B to the consolidated financial statements of Advance Ross Corporation for the year ended December 31, 1981. Such audit will be performed by Ernst & Whinney, whose fees and costs for such professional services shall be paid by Buyer or the Company, as Buyer shall choose.

(b) *Preservation of and Access to Books and Records.* Except to the extent that Seller shall transfer any of such books and records to Buyer as hereinafter provided, Seller shall, for a period of at least ten (10) years after the Closing Date, preserve or cause to be preserved all books and records in its possession or control (including, without limitation, books and records in the possession or control of Seller's attorneys and accountants) pertaining to the Company, and Seller shall make them available to Buyer or its authorized representatives at all reasonable times during said period for inspection and making copies and extracts therefrom for any proper purpose; and Seller shall permit Buyer to remove such books and records in connection with any proceedings, claims or actions which may be brought against Buyer or the Company in any judicial or formal or informal administrative proceeding or before any arbitration tribunal in connection with the Company.

• • •

5.03 *Indemnification.* If and to the extent that Buyer is damaged in an amount in excess of \$25,000.00 in the aggregate,



net of reimbursement by insurance or other third parties, by reason of a breach or breaches of any warranty, representation or covenant of Seller, including the existence of any tax deficiency, or any losses with respect to any claims described in SCHEDULE 2.09, Seller shall forthwith pay or credit to Buyer the amount of damages caused by said breach or breaches of warranty to the extent that the aggregate of such damages exceed said \$25,000.00. Seller shall indemnify, defend and hold Buyer and the Company harmless from and against any assessment, claim, lien or liability for taxes asserted against Buyer or the Company for any period prior to the Closing Date or for taxes of the Seller's consolidated group for any period prior to December 31, 1982. As a condition precedent to the right to enforce its right of indemnification, buyer is hereby required to give written notice of any claim of breach of warranty, representation or covenant to Seller within ninety (90) days after discovery of such breach. Additionally, Seller shall not have any liability to buyer for breach of warranty: (a) For any matter other than tax deficiencies unless a written claim is filed with Seller on or before December 31, 1984; and (b) For tax deficiencies unless a written claim is filed with Seller within 90 days of the expiration of the applicable statute of limitations. Notwithstanding the foregoing, the total amount to be paid or credited to Buyer hereunder shall not exceed \$800,000.00 in the aggregate.

5.04 *Accuracy of Representations and Warranties.* The representations and warranties set forth in ARTICLE II hereof shall be true and correct in all respects at and as of the Closing Date.

5.07 *Change of Board of Directors.* At the Closing, Seller shall take such steps as are reasonably necessary to cause all members of the Board of Directors of the Company to be comprised of persons designated in writing by Buyer.

• • •

## ARTICLE VI

### ADDITIONAL COVENANTS OF BUYER

Buyer hereby agrees:

6.01 *Indemnity from Claims of Brokers.* Buyer warrants and represents that it has not engaged any broker or finder in connection with this transaction other than Robert Berner, and that no person other than said Robert Berner has made any claim against it for any finder's fee. Buyer is solely responsible for any broker's or finder's fee payable to said Robert Berner, and Buyer agrees to indemnify and hold Seller harmless against or in respect of any commissions or brokerage fees incurred or alleged to be incurred pursuant to any alleged arrangements with Buyer.

• • •

6.06 *Accuracy of Representations and Warranties.* The representations and warranties set forth in ARTICLE II hereof shall be true and correct in all respects at and as of the Closing Date.

6.08 *Absence of Material Changes.* Between the date of the July 31, 1982 financial statements and the Closing Date, there shall have been no material adverse change in the financial position of the Buyer.

## ARTICLE VII

### PRODUCTS LIABILITY

7.01 *Seller's Indemnification.* Seller agrees to indemnify, defend and hold Buyer and the Company harmless from and against any products liability or similar claim or action relating to finished goods of the Company which were manufactured



prior to the Closing Date, including all costs, expenses and attorneys' fees in connection with the defense of any such action or claim.

7.02 *Buyer's Indemnification.* Buyer agrees to indemnify, defend and hold Seller harmless from and against any products liability or similar claim or action relating to finished goods of the Company which are manufactured after the Closing Date, including all costs, expenses and attorneys' fees in connection with the defense of any such action or claim.

\* \* \*

## ARTICLE VIII

### MISCELLANEOUS MATTERS

8.01 *Notices.* Any notice, request, instruction, or other document deemed by either party to be necessary or desirable to be given to the other party shall be in writing and shall be mailed by registered or certified mail, postage prepaid, with return receipt requested, addressed as follows:

TO SELLER: Mr. Harve A. Ferrill, President  
ADVANCE ROSS CORPORATION  
111 West Monroe Street  
Chicago, Illinois 60603

with a copy to: Harvey Nixon, Esq.  
MAYER, BROWN & PLATT  
231 South LaSalle Street  
Chicago, Illinois 60604

TO BUYER: Mr. Robert W. Miller, Chairman  
ALGERAN, INC.  
890 South Arroyo Parkway  
Pasadena, California 91105

with a copy to: Michael D. Miller, Esq.  
STERN & MILLER, a  
Professional Corporation  
606 Wilshire Boulevard, Suite 706  
Santa Monica, California 90401

TO COMPANY: Mr. Tom Carlsen  
Chief Financial Officer  
AMI INDUSTRIES, INC.  
3200 North Nevada  
Colorado Springs, Colorado 80907

8.02 *Entire Agreement.* This Agreement contains the entire agreement between the parties hereto and supersedes any and all prior agreements, arrangements, or understandings between the parties relating to this Agreement. No oral understandings, statements, promises or inducements contrary to the terms of this Agreement exist. No representations, warranties, covenants or conditions, express or implied, whether by statute or otherwise other than as set forth herein, have been made by any party hereto. No waiver of any term, provision or condition of this Agreement, whether by conduct or otherwise, in any one or more instances shall be deemed to be or construed as a further or continuing waiver of any such term, provision, or condition or any other term, provision or condition of this Agreement. This Agreement cannot be changed or terminated orally.

8.03 *Applicable Law.* This Agreement shall be governed by, and construed and enforced in accordance with, and subject to, the laws of the State of California.

8.04 *Arbitration of Disputes.* In the event any controversy or claim as to matters arising out of this Agreement cannot be settled by the parties or their legal representatives, such con-

trovery or claim shall be settled by arbitration in accordance with the then current rules of the American Arbitration Association and judgment upon the award may be entered in any court having jurisdiction thereof.

8.05 *Binding on Successors.* All of the terms, provisions and conditions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their successors in interest of every kind and nature whatsoever.

8.06 *Survival of Representations.* All representations, warranties, agreements and covenants made by the parties hereto in this Agreement or pursuant hereto shall be deemed to have been made for the purpose of inducing the other party to enter into this Agreement, and shall survive the Closing and remain operative thereafter to and through December 31, 1984 but all representations, warranties, agreements and covenants of Seller contained in Section 2.07 concerning taxes shall remain operative until the applicable statute of limitations concerning the assessment and collection of taxes has expired.

8.07 *Titles.* The titles of the articles and sections of this Agreement are for convenience of reference only and are not to be considered in construing this Agreement.

8.08 *Counterparts.* This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which taken together shall constitute one and the same document.

8.09 *Exhibits and Schedules.* To the extent that any exhibits or schedules have not previously been delivered to Buyer or Seller, Buyer and Seller agree to deliver such exhibits and schedules at the Closing. With respect to any exhibits or schedules delivered by either Buyer or Seller prior to the Closing, Buyer or Seller, as the case may be, shall provide the other with a certificate which represents, warrants and covenants that there have been no changes in or to such exhibits or schedules except as disclosed in the certificate.

IN WITNESS WHEREOF, the parties hereto set their hands on the day and year first above written.

SELLER: ADVANCE ROSS CORPORATION

By /s/ Harve A. Ferrill  
Harve A. Ferrill  
President

AD ROSS CORPORATION

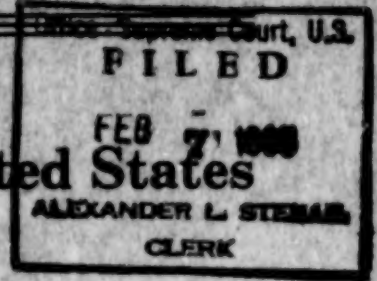
By /s/ Harve A. Ferrill  
Executive Vice President

BUYER: ALGERAN, INC.

By /s/ Robert R. Susnar  
Robert R. Susnar,  
President

[Schedules and Exhibits Omitted]

IN THE  
Supreme Court of the United States



October Term, 1984

LANDRETH TIMBER COMPANY,  
*Petitioner,*

v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
AND KATHLEEN LANDRETH,  
*Respondents.*

ON WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

**BRIEF OF RESPONDENTS**

James A. Smith, Jr.\*  
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2200 Bank of California  
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Seattle, WA 98164  
(206) 682-5151

\**Counsel of Record*

60pp



## QUESTION PRESENTED

Is the privately negotiated sale of a closely held business, effectuated by the transfer of 100% of the company's stock to a sophisticated corporate purchaser which assumes complete control over the business, a transaction in securities under the Securities Act of 1933 and the Securities Exchange Act of 1934?<sup>1</sup>

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<sup>1</sup> Hereinafter the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* (1983), and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* (1983), are individually referred to as the "1933 Act" or "1934 Act," and collectively referred to as "the Acts."

## PARTIES INVOLVED

Petitioner Landreth Timber Company ("LTC II") is a Delaware corporation. LTC II is the successor in interest to B&D Company, Inc. ("B&D"),<sup>2</sup> which purchased 100% of the shares of Landreth Timber Company, Inc. ("LTC I") from the respondents. LTC II was the plaintiff below.

Respondents are Ivan K. Landreth, Lucille Landreth, Thomas E. Landreth, Ivan K. Landreth, Jr. and Kathleen Landreth ("the Landreths"), formerly owners of all of the stock of LTC I, a closely held corporation. The Landreths were the defendants below.

<sup>2</sup> Contrary to the repeated suggestion in Petitioner's Brief, Messrs. Bolten and Dennis, the largest individual shareholders of B&D, are not parties to this action. The sole petitioner herein is LTC II, a corporate entity which is the successor in interest to B&D, a corporation which acquired 100% of the stock of LTC I. See n. 12, *infra*.

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No. 83-1961

IN THE

## Supreme Court of the United States

October Term, 1984

LANDRETH TIMBER COMPANY,  
*Petitioner,*

v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
AND KATHLEEN LANDRETH,  
*Respondents.*ON WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

BRIEF OF RESPONDENTS

## I. STATEMENT OF THE CASE

## A. The Narrow Scope of Factual Inquiry.

The sole question before this Court is whether the sale of a family-owned sawmill business to a sophisticated corporate purchaser, accomplished by the transfer of 100% of the business' stock, constitutes a transaction in securities within the meaning of the Acts. The facts pertinent to this inquiry relate solely to the economic realities of the underlying transaction, i.e., whether the transaction involves an investment of money in a common enterprise premised on an expectation of profits to be derived from the entrepreneurial or managerial efforts of others. The record below<sup>3</sup> contains a number of admitted facts<sup>4</sup> which, standing alone, are sufficient to resolve these issues.

<sup>3</sup> Citations to the record from the District Court for the Western District of Washington as certified by the Clerk of the Court of Appeals for the Ninth Circuit, appear as ("R. [Record number] at [page within document]"). The title of, and an identifying reference to, each cited document is contained in Appendix A to this Brief.

<sup>4</sup> In its application of the "economic realities" test to this transaction, the district court relied on Defendants' Requests to Plaintiff for Admissions of



In its brief, LTC II makes extensive allegations of fraud and misrepresentation, all of which are denied by the Landreths. There have been *no* findings of fraud or misrepresentation in the proceedings below, and LTC II's allegations are vigorously contested by the Landreths.<sup>5</sup>

These allegations, while misleading and susceptible to rebuttal, are totally irrelevant to the issue now before this Court. See *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 859 (1975). Thus, the analysis of critical facts contained herein will be directed solely to the question of whether this was a transaction in "securities" within the meaning of the Acts.

#### B. Analysis of Critical Facts.

The Landreths were the owners of LTC I, a sawmill business located in eastern Washington. Prior to the sale of LTC I to B&D, the Landreths owned all of its outstanding stock (J.A. 182). The single most valuable asset of the business was a lumber manufacturing plant, which had been

[footnote continued]

Fact Concerning Post-Closing Corporate Control and Responses Thereto (the "admissions of fact") (J.A. 178-335). LTC II's admissions before the district court, as discussed herein, not only firmly establish that the criteria of the "economic realities" test were not met, but also directly contradict several of the factual allegations contained in Petitioner's Brief.

<sup>5</sup> LTC II's allegations of fraud and misrepresentation are without merit. Because these claims are irrelevant to the question currently before this Court, they are addressed summarily herein. However, when these issues are heard on their merits, the evidence will show that there were no misrepresentations or breaches of warranties by the Landreths regarding: (1) the capacity of the mill; (2) the amount of overrun which could be produced by the mill; (3) the estimated date of completion of mill reconstruction; or (4) the cost of completion. Furthermore, the evidence will show that the problems encountered by LTC II were the result of LTC II's own mismanagement, improper reconstruction of the mill after closing of the sale, unnecessary expenditures, fraud by LTC II's own mill manager, and LTC II's own poor marketing decisions.

partially destroyed by fire (J.A. 182). At the time of the sale to B&D, the mill was under reconstruction and was not manufacturing lumber (J.A. 182).

In 1976, the Landreths listed their sawmill business for sale.<sup>6</sup> Jack Branch ("Branch"), a timber broker<sup>7</sup> who later became a shareholder and represented himself to be an officer of LTC II, learned of the mill from a real estate broker with whom the Landreths had listed the property (R. 69 at 242; R. 93 at 157). Branch mentioned the sawmill to Al Willard, who subsequently contacted Samuel Dennis III ("Dennis"), with whom he had worked on other business transactions (J.A. 96-100). Dennis was a senior partner and tax attorney with the Boston law firm of Hale & Dorr, and had been a principal in Standex International Corporation, a publicly-traded company which had acquired over 100 businesses in a twenty-five year period (R. 69 at 5, 141).

<sup>6</sup> Contrary to LTC II's assertion, the Landreths did not list "stock" for sale in 1976. To the contrary, the listing cited by LTC II actually was placed with a limited number of real estate and business brokers in Oregon and Washington and offered a "lumber manufacturing facility" (R. 93 at 158; R. 70 at 2). Such listing further stated that the Landreths were offering their "business for sale" and that they would consider selling by transfer of stock or a sale of assets comprising the lumber manufacturing facility. There is no evidence that the mill was "widely offered" as alleged by LTC II. Pet. Br. at 10.

<sup>7</sup> Throughout its brief, LTC II refers to an unnamed "broker," implying that he was an agent of the Landreths. See, e.g., Pet. Br. at 3, 5. This is untrue. Dennis, the key member of the purchasing group, after learning the mill was for sale, contacted Branch, a timber broker and president of Timber West, Inc., asking that he serve as Dennis' agent in negotiating a purchase of the mill. Branch was promised a 25% ownership interest in the acquiring corporation if negotiations were successful, and was led to believe that Timber West would receive a monthly management fee for overseeing mill operations (J.A. 103-04; R. 69 at 174-75, 244-45). Branch assisted in negotiating the purchase on Dennis' behalf, retained outside consultants to evaluate the mill on behalf of Dennis, and hired the new mill manager, Phil Cook, to replace Ivan Landreth at closing (see, e.g., J.A. 105, 135, 292-95). In return, Branch received shares of stock in the acquiring company and represented that he was its vice-president (J.A. 185, 309; R. 69 at 246-47).



During the summer of 1977, Dennis initiated negotiations with Ivan Landreth ("Landreth") (R. 69 at 181-82). Those negotiations led to the execution of a Stock Purchase Agreement on October 6, 1977 pursuant to which Dennis, as an accommodation buyer, agreed to acquire the Landreths' sawmill business by transfer of all of the stock of LTC I (J.A. 206-63). Prior to Dennis' execution of this Stock Purchase Agreement, the purchaser conducted a comprehensive investigation of the assets and liabilities of LTC I including: (1) personal visits to the mill by Dennis, Branch, and the purchaser's new mill manager, Phil Cook ("Cook"), (2) a review of books and records by a certified public accountant, Peter Townsend, (3) an appraisal of the mill facility by the engineering firm of Pease & Beadling, and (4) a review of the mill by Robert Ingram, a loan officer with one of the banks financing the purchase, who was familiar with sawmill operations (J.A. 115-34; R. 69 at 161, 171, 174-75, 179-80, 310-14; R. 69 at 93-122). The sale closed on November 17, 1977 (J.A. 183).

At closing, under an "Assignment of, and Amendment to Stock Purchase Agreement" (the "Amended Stock Purchase Agreement"), B&D was substituted for Dennis as the purchaser of LTC I (J.A. 183, 204). B&D had been formed by the purchasing group for federal tax reasons, and under the terms of an Agreement and Plan of Merger dated November 17, 1977, LTC I was merged into B&D, which then continued to conduct the sawmill business under the name "Landreth Timber Company, Inc." (J.A. 183-84).

The Stock Purchase Agreement and Amended Stock Purchase Agreement were drafted by a cadre of lawyers in Seattle and Boston who had been retained by Dennis (J.A. 278, 300; R. 69 at 152-58, 228-29). The agreements contained extensive warranty provisions and other protections for the purchaser (J.A. 206-63). Noticeable by way of absence, however, was any reference to the federal securities laws in either the text of the purchase agreements or the written or oral negotiations between the parties.

LTC II's admissions of fact before the district court unequivocally demonstrate the following: (1) there was absolutely no "common enterprise" among the sellers and the purchaser after closing; and (2) the purchaser assumed complete control of the enterprise at closing, and thereafter operated the business without reliance on the Landreths. Specific admissions of fact by LTC II, many of which directly contradict allegations now raised in Petitioner's Brief, include the following:

1. Under the Stock Purchase Agreement the Landreths agreed to sell 100% of the stock of LTC I to a corporation to be formed by the purchasing group, and Dennis executed that Agreement as an accommodation buyer on behalf of the corporation (J.A. 182, 204).
2. The purchasing entity, B&D, was formed "solely for federal tax reasons" in order to effectuate the purchase of the Landreths' stock (J.A. 204).
3. Under the Stock Purchase Agreement the Landreths agreed to resign as officers and directors of LTC I, and such resignations in fact occurred (J.A. 184).
4. None of the Landreths became officers, directors, shareholders, or employees of the acquiring company, or held any other interest in B&D (J.A. 184).
5. None of the Landreths became officers, directors, shareholders or had any other ownership interest in LTC II (J.A. 185).
6. None of the Landreths had a right to share in the profits or losses of LTC II (J.A. 186, 204).
7. The purchasing group selected and retained its own mill manager, prior to closing. Cook assumed the position of general manager of LTC II at closing (J.A. 186-88).
8. After closing Landreth's role was limited to that of a consultant retained by LTC II pursuant to a consulting agreement (J.A. 188).

9. Under the consulting agreement, Landreth had no right to share in profits, receive commissions, or obtain any other compensation dependent upon the profitability of LTC II (J.A. 189).
10. Landreth's post-closing employment was terminable at will by LTC II (J.A. 190).
11. After closing, Landreth did not possess authority to make decisions for LTC II regarding hiring or firing employees, writing checks, setting salaries, entry into log purchase contracts,<sup>\*</sup> product mix, sale prices, expenditures for equipment acquisition and maintenance, reconstruction and design of the mill, or any related matters (J.A. 191-98).
12. On the other hand, LTC II's mill manager, had the authority to and did make all of the above decisions (J.A. 191-98).
13. By letter dated December 19, 1977, approximately one month after closing, Branch, vice president of the purchaser, wrote to Cook, LTC II's mill manager, unequivocally telling him that Landreth was no longer involved in the acquired company:

*Ivan Landreth and his sons have sold 100% of the stock of Landreth Timber Company to B&D Corporation which subsequently will change its name back to Landreth Timber Company. Ivan Landreth has no stock whatsoever in the company and has been retained on an interim basis for perhaps one to three months as a consultant on matters relating to the orderly transition in sales, contracts, customers, etc. In the event any of your personnel have any*

<sup>\*</sup> LTC II's admissions of fact before the district court belie its current assertion that Landreth bid on Forest Service sales after closing. Pet. Br. at 8-9. In fact, Landreth lacked the authority to make such commitments, which instead were the exclusive responsibility of LTC II's own mill manager (J.A. 192).

*vague notions or concerns as to whether Ivan is still involved in the company, please be sure that he is not and although he is still around the mill, more or less tidying up his affairs, we will have no further use for his services in a short period of time.*

(J.A. 297-98) (emphasis added).

14. In a letter dated January 10, 1978, less than two months after LTC I was sold, Branch notified Landreth that his employment as a consultant was terminated (J.A. 201, 309).

In summary, as of the date of closing, the purchaser obtained complete ownership of the Landreths' sawmill business, and exerted absolute control over the business. After closing there was no element of common enterprise between the purchaser and the Landreths.

### C. Summary of Proceedings Below.

LTC II commenced this action in November, 1978, alleging federal securities law violations, as well as numerous state and common law claims. Thereafter, LTC II filed a virtually identical state court action,<sup>9</sup> excluding the claims for violation of the federal securities laws. The Landreths moved for summary judgment in the district court action on the basis that the sale of the Landreths' sawmill business was not a transaction in "securities" under the Acts, and therefore the Court lacked subject matter jurisdiction over LTC II's claims.

On February 27, 1981, Judge Barbara Rothstein concluded that the economic realities of the underlying transaction should be examined in determining whether the sale of the Landreths' sawmill business was a transaction

<sup>9</sup> *Landreth Timber Co. v. Ivan K. Landreth et al.*, State of Washington, County of King, Cause No. 80-2-11740-8.



in securities under the Acts (J.A. 173-77). The court subsequently conducted a hearing directed at the issue of the purchaser's assumption of post-closing control — i.e., whether under the "economic realities" test LTC II expected profits from the entrepreneurial or managerial efforts of others, or whether LTC II itself controlled the enterprise and determined the outcome of its investment after closing (J.A. 174-75). On April 29, 1981 the district court issued an order granting summary judgment in favor of the Landreths;<sup>10</sup> and, on May 27, 1981, dismissed LTC II's claims.<sup>11</sup>

On March 7, 1984, the United States Court of Appeals for the Ninth Circuit affirmed the district court's decision. *Landreth Timber Co. v. Landreth*, 731 F.2d 1348 (9th Cir. 1984). The Court applied the "economic realities" test to determine whether the sale of 100% of the shares of LTC I stock constituted a transaction in "securities." The Ninth Circuit concluded that, under any formulation of the sale of business doctrine, the economic realities of the Landreth transaction left no doubt that it was the sale of a business, not an investment in securities. 731 F.2d at 1353.<sup>12</sup>

## II. SUMMARY OF ARGUMENT

In determining whether the sale of a business through the transfer of 100% of a corporation's stock to a single corporate purchaser is a sale of a "security," this Court must adhere to the principles which have guided all of its decisions defining a "security" under the Acts. This Court has

<sup>10</sup> The Court's Order Granting Summary Judgment is attached as Appendix B to this brief.

<sup>11</sup> The state court action remains pending.

<sup>12</sup> The Ninth Circuit also rejected the attempt of Dennis and the estate of John Bolten to intervene on appeal as individual parties plaintiff. 731 F.2d at 1353. This renders even more transparent LTC II's attempts to suggest in its brief that Dennis and Bolten as individuals, rather than a corporate entity, were the purchasers of the shares of LTC I. See, e.g., Pet. Br. at 42-43.

developed, and consistently applied, an "economic realities" test which embodies the essential attributes of a "security": i.e., whether there is an investment in a common enterprise, in reliance upon an expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

In applying this test, the Court is not bound by the name appended to an instrument. "Stock" is only one of a number of different instruments listed within the definition of a "security" under the Acts which, depending on the economic realities underlying the transaction, may constitute a "security." This Court has expressly rejected the literal approach now urged by LTC II and the S.E.C., and has refused to adopt an inflexible rule barring inquiry into the economic realities underlying a transaction.

Application of the "economic realities" test to the sale of a business through the transfer of 100% of its stock is consistent with the legislative intent of the Acts to regulate and prevent abuses in publicly traded securities. The primary concern of the federal securities laws is the protection of investors who provide venture capital and relinquish control over their investment, expecting to receive profits from the entrepreneurial or managerial efforts of others.

The transactional analysis embodied in the "economic realities" test has been consistently applied by this Court in numerous contexts involving a variety of different instruments, including investment contracts, withdrawable shares in a savings institution, stock in a housing cooperative, an employee pension plan, a certificate of deposit, and a privately negotiated profit-sharing agreement. In all of its decisions defining a security, the Court has looked outside the instrument itself and analyzed the economic realities underlying the transaction.

Applying the economic realities test to the facts of this case, the privately negotiated sale of LTC I, accomplished through the transfer of 100% of LTC I's stock to B&D, did not constitute the sale of a "security" under the Acts because: (1) there was no common enterprise among the purchaser and



sellers, and (2) the purchaser assumed and exercised complete control over the business, and thus did not rely on the managerial or entrepreneurial efforts of others.

Policy considerations also support the conclusion that the sale of LTC I is not a transaction in securities. All of the Court's prior decisions have applied the "economic realities" test, regardless of the type of instrument involved. The applicability of the "economic realities" test to the sale of a business accomplished through the transfer of stock is consistent with the intent of the Acts to protect passive investors who lack the ability to control the outcome of their investment.

By contrast, adoption of the "traditional characteristics" test proposed by LTC II and the S.E.C., which precludes inquiry into the underlying economic realities of a transaction and would determine the applicability of the securities laws based upon whether a document has the "traditional attributes" of an instrument enumerated in the statute, is contrary to the language and purpose of the Acts. The "traditional characteristics" test has never been applied by this Court, which instead has chosen to determine the existence of a security based upon the transactional context. The adoption of the "traditional characteristics" test is unworkable as applied to several instruments named in the Acts, (e.g., notes), and ultimately would require the creation of a number of different tests depending upon the *instrument* involved, ignoring the economic realities of the underlying *transaction*.

Courts can apply the "economic realities" test in a fair and predictable manner. When the underlying transaction involves the sale of 100% of a corporation's stock, there is neither a common enterprise nor reliance on the efforts of others, and, as a matter of law, there is no transaction in securities subject to the Acts. If the sale of stock involves a transfer of less than 100% ownership of the business enterprise, then a court can evaluate the economic realities of the underlying transaction based upon the record before

it if there is no material issue of fact, or by way of an evidentiary hearing if a factual issue exists.

The application of the "economic realities" test to the sale of a business is consistent with the intent of Congress to provide a remedy for passive investors, while excluding from coverage entrepreneurs who purchase and actively control a business, for whom Congress intended no special protection under the Acts.

### III. ARGUMENT

#### A. The Structure of the Acts Requires Examination of the Transactional Context in Order to Determine the Existence of a Security.

The definitions found in both the Securities Act of 1933 and the Securities Exchange Act of 1934 are the starting point for determining whether a given transaction involves a "security" under the Acts. 15 U.S.C. § 77b; 15 U.S.C. § 78c. "Stock" is merely one of approximately seventeen instruments identified within the definition of a "security," and is given no more dignity or emphasis than any other instrument under the Acts. Stock is merely one type of instrument which, depending upon its transactional context, *may* constitute a "security."<sup>13</sup> Congress left it to the courts to identify the specific criteria which distinguish securities from non-securities depending upon the economic realities of the underlying transaction. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 847-48 (1975).

<sup>13</sup> See, *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 850 (1975). The need for analysis of the transactional context in which the enumerated instrument is used is emphasized by the fact that the term "note" is the first listed instrument in the definitional sections of the Acts. While an instrument with all the traditional characteristics of a note may constitute a security, in many instances such instrument will not fall within the scope of the Acts. Section III.E.2, n.27, *infra*.

The definitional sections of the Acts are preceded by the phrase "unless the context otherwise requires . . ." 15 U.S.C. § 77b; 15 U.S.C. § 78c. If LTC II's literalist interpretation of the Acts is correct, requiring the Court to determine the existence of a security solely on the basis of whether a named document has the traditional characteristics of an instrument identified in the Acts, then this statutory language would be superfluous. On the contrary, this Court has indicated that the "context clause" in the Acts is of substantial importance, requiring an analysis of the economic realities of the underlying transaction in order to determine whether a security exists.

We have repeatedly held that the test is "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect." *S.E.C. v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967), quoting *S.E.C. v. C.M. Joiner Leasing Corp.*, *supra*, at 352-353.

The broad statutory definition is preceded . . . by the statement that the terms mentioned are not to be considered securities if "the context otherwise requires . . ."

*Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982). Thus, based upon this analysis of the statute, the Court in *Marine Bank* held that an instrument enumerated in the 1934 Act was not a "security" when viewed in its *transactional context*. *Id.* at 560 n.11.

**B. The Legislative Intent in Promulgating the Acts Was to Protect Passive Investors Who Provide Venture Capital in Reliance on the Entrepreneurial or Managerial Efforts of Others.**

The issue before this Court is whether the Acts should be applied to a transaction involving the sale of a business where there is no common enterprise among sellers and purchaser and where the purchaser assumes complete control over the operation of the business. As in all cases of statutory

construction, it is necessary for the Court to interpret the definitional provisions of the statute in light of the purposes Congress sought to serve.<sup>14</sup>

The purchaser of an entire business is not within the class of investors whom the Acts sought to protect.<sup>15</sup>

The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors.

*United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 (1975).

This view is supported by the legislative history of the Acts, which is replete with concern for the protection of passive investors. In adopting the 1933 Act, Congress sought to eliminate serious abuses in the largely unregulated securities market and to:

[R]eturn to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other peoples' money are trustees acting for others.

H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933).

<sup>14</sup> *Chapman v. Houston Welfare Rights Organization*, 441 U.S. 600, 608 (1979); *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 (1975); *S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351-52 n.8 (1943).

<sup>15</sup> Fundamentally implicit in the sale of business doctrine is the proposition that the federal securities laws were enacted to protect passive investors, not entrepreneurs who buy and thereafter control entire businesses. *Landreth Timber Co. v. Landreth*, 731 F.2d 1348 (9th Cir. 1984); *Christy v. Cambron*, 710 F.2d 669 (10th Cir. 1983); *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982); *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982); see also, Easley, *Recent Developments in the Sale of Business Doctrine*, 39 Bus. Law. 929 (1984); Seldin, *When Stock is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 Bus. Law. 637 (1982); Thompson, *The Shrinking Definition of a Security: Why Purchasing All of a Company's Stock is Not a Federal Securities Transaction*, 57 N.Y.U. L.Rev. 225 (1982); McAneny, *Acquisition of Businesses Through Purchase of Corporate Stock: An Argument for Exclusion From Federal Securities Regulation*, 8 Fla. St. U.L. Rev. 295 (1980).



Nowhere in the legislative history is there mention of entrepreneurs. The statement of Congressman Sam Rayburn, Chairman of the House Committee on Interstate and Foreign Commerce and one of the principal sponsors of the 1933 Act, reflects the concerns of Congress:

We have, on the one hand, 18,000,000 *passive citizens* having no actual contact with their companies; on the other hand, a few hundred *powerful managers directing and controlling the destinies of the companies and the physical properties which they own*. The owners of these symbols are entitled to know what the symbols represent. Those who are interested in purchasing these pieces of paper have the right to demand information as to the actual condition of the issuing company. Up to this time such information has depended on the grace of an entrenched management. These managers are truly trustees.

77 Cong. Rec. 2910, 2918 (1933) (emphasis added).

Congressman Rayburn stressed that the purpose of the 1933 Act was to protect those who are not in a position to actually manage the property represented by the instrument they acquire, and who are unable to meaningfully control the success or failure of the venture:

Today the owner does not possess actual physical properties but he holds a piece of paper which represents certain rights and expectations. . . . [T]he owners of these pieces of paper have little control over the physical property [and] carry no actual responsibility with respect to the enterprise or its physical property. . . . [T]he wealth of a particular person is coming more and more to depend on forces beyond his own reach and control.

*Id.* at 2917.

The purpose of the 1934 Act is equally clear in its protection of passive investors. The House Committee on Interstate and Foreign Commerce, in its report regarding the

1934 Act, observed that the impetus for the legislation was the fact that corporate "[o]wnership and control are in most cases largely divorced." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 3 (1934). The Act was not directed to situations where management and ownership are united, in which a common enterprise does not exist:

When corporations were small, when their managers were intimately acquainted with their owners and when the interests of management and ownership were substantially identical, conditions did not require the regulation of security [markets].

*Id.* at 5. This Congressional concern to protect investors who provide venture capital to be used by promoters and managers of businesses is pervasive throughout the legislative history of the 1934 Act. See S. Rep. No. 792, 73d Cong., 2d Sess. 4-7, 11-12, 18 (1934).

A corporate entity, such as LTC II, which purchases an entire business and thereafter controls its fortunes, is an entrepreneur, not a passive investor. The seller of a business, such as the Landreths, who retains no control over the enterprise does not serve as a trustee of the purchaser's investment, and thus there is no "common enterprise" after the sale. The difference between an investor who lacks control over the outcome of his investment, and a purchaser of an entire business who has complete entrepreneurial control, is the foundation of the sale of business doctrine. It is a distinction well recognized by both Congress and the prior decisions of this Court.

### C. In All of Its Decisions Defining a "Security," This Court Consistently Has Analyzed the Economic Realities Underlying A Transaction.

The following section discusses, in chronological order, this Court's decisions defining a "security." This analysis demonstrates that in determining whether a particular



transaction involves a "security," the Court consistently has looked beyond the instrument itself and has analyzed the economic realities of the underlying transaction. This Court expressly has rejected a literal approach, such as that now urged by LTC II, which would bar inquiry into the economic realities underlying the transaction in which the instrument was transferred. The Court has developed a coherent test for determining whether there is a "security transaction" within the meaning of the Acts: whether it involves an investment in a common enterprise premised on a reasonable expectation of profits to be derived from the managerial or entrepreneurial efforts of others. This analysis applies regardless of the type of instrument involved.

1. *S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943).

In *Joiner*, the Court considered whether assignments of interests in oil leases, offered by mail to over 1,000 prospective investors and conditioned upon the promoter's promise to drill exploratory wells, constituted "sales of securities" within the meaning of the 1933 Act. In analyzing the definition of the term "security,"<sup>16</sup> the Court applied the doctrine that

[C]ourts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permit so as to carry out in particular cases the generally expressed legislative policy.

320 U.S. at 350-51.

The Court recognized that Congress defined the term "security" to include "by name or description many documents in which there is common trading for speculation or investment." 320 U.S. at 351. The Court ruled that the relevant inquiry for determining whether a transaction falls within the terms of the 1933 Act is:

<sup>16</sup> Section 2(1) of the 1933 Act, 15 U.S.C. § 77b(1).

[W]hat character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.

320 U.S. at 352-53 (emphasis added). Rejecting an "inflexible rule barring inquiry into the economic realities underlying a transaction,"<sup>17</sup> the Court concluded, on the basis of proof "outside the instrument itself" that the context of the transaction brought the instrument within the terms of the 1933 Act. 320 U.S. at 355.

2. *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946).

In *Howey*, the Court considered whether an offering of sales contracts on units in a citrus grove development, coupled with service contracts giving the promoter full discretion and authority to cultivate the groves, market the produce, and allocate and distribute profits, constituted an investment contract and hence a "security" within the 1933 Act. Endorsing an analysis which favors substance over form and focuses on the economic realities underlying the transaction, the Court ruled that the test is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U.S. at 301.

The Court stated that its three-part test is consistent with the statutory aims of the Act and that it

[E]mbodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.

328 U.S. at 299. The Court applied the test to the underlying sales transaction and concluded that all of the elements of a "profit seeking business venture" were present:

<sup>17</sup> *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 850 (1975) (interpreting its ruling in *S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943)).

The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise.

328 U.S. at 300.

3. *Tcherepnin v. Knight*, 389 U.S. 332 (1967).

In *Tcherepnin*, the Court considered whether withdrawable capital shares in a state savings and loan association constituted a "security" within the meaning of § 3(a)(10) of the 1934 Act. The Court acknowledged that the definition of "security" in the 1934 Act was virtually identical to the definition of "security" in section 2(l) of the 1933 Act. The Court ruled that:

[I]n searching for the meaning and scope of the word "security" in the Act, *form should be disregarded for substance and the emphasis should be on economic reality.*

389 U.S. at 336 (citing *Howey*, 328 U.S. at 298) (emphasis added).

Substituting the word "security" for "it"<sup>18</sup> in a key quote from *Howey*, the *Tcherepnin* Court stated that the term "security," as used in the Acts, describes "various schemes devised by those who seek the use of the money of others on the promise of profits." 389 U.S. at 338 (quoting *Howey*, 328 U.S. at 299). Acknowledging that the withdrawable shares in the underlying transaction had all the attributes of three of the instruments enumerated in the 1934 Act — investment contracts, certificates of interest, and stock — the Court analyzed the investment scheme under the *Howey* test and determined that the investors were

[P]articipants in a common enterprise — a money-lending operation dependent for its success upon the skill and efforts of the management of [the savings and loan] in making sound loans.

389 U.S. at 338.

<sup>18</sup> The word "it" as used in the quote from *Howey* refers to the definition of an "investment contract."

4. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

In *Forman*, the Court considered whether the sale of stock entitling a purchaser to occupy an apartment in a state-subsidized housing co-operative was a sale of a "security" within the meaning of the Acts. The district court had ruled that denominating the instruments as "stock," by itself, did not make the stock a "security." The district court also concluded that the purchase of the stock was not a "security transaction" because it was not induced by the purchasers' expectation of profits. 421 U.S. at 845. The Second Circuit had reversed the district court's decision on two alternative grounds: (1) the Acts were literally applicable because "stock" was one of the specifically enumerated documents in the statutory definition of "security"; and (2) the transaction was an "investment contract" under the *Howey* criteria because profits were expected from the efforts of others.

Ruling that the transactions were not "purchases of securities" within the contemplation of the Acts, this Court reversed the court of appeals' decision. 421 U.S. at 847. The Court divided its opinion into two parts, addressing separately each of the bases upon which the Second Circuit had ruled.

Part A of the opinion addresses the circuit court's literal application of the Acts. The Court recognized that Congress defined the term "security" only in terms of instruments which commonly fell within the ordinary concept of a security, and that it did not set forth the pertinent economic criteria for distinguishing "securities" from non-securities. 421 U.S. at 847. The Court ruled that the task of determining which "of the myriad financial transactions in our society" constitute "transactions in securities" ultimately falls to the federal courts. 421 U.S. at 847-48.

The Court unequivocally rejected the "literal approach" adopted by the Second Circuit that a transaction evidenced by the sale of "stock" is a security transaction simply because



"stock" is one of the specifically enumerated instruments in the statutory definition of a "security." 421 U.S. at 848.

Instead, the Court adhered to a substantive analysis of the economic realities underlying the transaction which, in the Court's words, has guided "all of [its] decisions defining a security." 421 U.S. at 852 (quoting *Tcherepnin*, 389 U.S. at 336) (emphasis added).

The Court considered the purpose and focus of the Acts and determined that Congress intended coverage of the Acts to turn on the economic realities underlying the transaction and not on the name appended to the instrument:

Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction and not on the name appended thereto.

421 U.S. at 849 (emphasis added).

The Court recognized that an instrument could fall within the "letter of the statute" and yet not be covered by the Acts because in its commercial context the instrument was not within the statute's spirit or intent. 421 U.S. at 849. The Court expressly rejected the position that its dicta in *Joiner* supported a "literal approach" to defining a security." 421 U.S. at 849. Underscoring the conditional tense of its language in *Joiner*, the *Forman* court stated:

Respondents' reliance on *Joiner* (sic) as support for a "literal approach" to defining a security is misplaced. . . . In dictum the [*Joiner*] Court noted that "[i]nstruments may be included within [the definition of a security], as [a] matter of law, if on their face they answer to the name or description." . . . And later, again in dictum, the [*Joiner*] Court stated that a security "might" be shown "by proving the document itself, which on its face would be a note, a bond, or a share of stock." . . . By using the conditional words "may" and "might" in these dicta the Court made clear that it was not establishing an inflexible rule barring inquiry into the economic realities underlying a transaction.

421 U.S. at 850 (citations omitted) (emphasis in original).

In concluding Part A of its opinion, the Court held that the "name" of an instrument, although not "wholly irrelevant," is not dispositive in determining whether the instrument is involved in a "security transaction":

In holding that the name given to an instrument is not dispositive, we do not suggest the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the *underlying transaction* embodies some of the significant characteristics typically associated with the named instrument.

421 U.S. at 850-51 (emphasis added).

In Part B of the *Forman* decision, the Court addressed the question of whether the shares of stock were "investment contracts" or "instruments commonly known as a 'security'." The Court stated that, for purposes of analyzing a transaction to determine if it involves a "security," the Court does not distinguish between investment contracts and other instruments commonly known as securities:

In considering these claims we *again* must examine the substance — the economic realities of the transaction — rather than the names that may have been employed by the parties.

421 U.S. at 851-52 (emphasis added). The Court recognized that *Howey* set forth the basic test for determining whether a particular transaction is a "transaction in securities," regardless of the name of the instrument involved:

In either case, the basic test for distinguishing the transaction from other commercial dealings is

"whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."

421 U.S. at 852 (quoting *Howey*, 328 U.S. at 301).



The Court's language left no doubt that the economic criteria enunciated in *Howey* are applicable to all transactions in which the existence of a security is in issue:

[The *Howey*] test in shorthand form, embodies the essential attributes that run through *all* of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

421 U.S. at 852 (emphasis added).

The Court also stated that the essential elements which distinguish a transaction in securities from other commercial dealings are absent in a situation where a purchaser acquires an asset for the purpose of using, developing, or managing it himself. 421 U.S. at 852-53. The Court ruled that:

"[W]hat distinguishes a security transaction — and what is absent here — is an investment where one parts with his money in the hopes of receiving profits from the efforts of others."

421 U.S. at 858.

The Court's holding that "we decide only that the *type of transaction* before us . . . is not within the scope of the federal securities laws" reinforces the principle that the relevant focus is on the underlying transaction, not on the instrument used. 421 U.S. at 859 (emphasis added).

5. *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979).

In *Daniel*, the Court considered whether a non-contributory, compulsory pension plan was a "security" within the meaning of the Acts. The pension plan was established by a collective bargaining agreement and could not be waived by employees. It required the employer to make fixed weekly contributions based on the number of eligible employees.

The Court analyzed the economic realities underlying the transaction, acknowledging again that the *Howey* criteria not only determine the presence of an investment contract but also "embod[y] the essential attributes that run through all of the Court's decisions defining a security." 439 U.S. at 558 n.11 (citing *Forman*, 421 U.S. at 852). The Court also noted that the *Howey* test would be equally applicable if the pension plan had all of the attributes of a certificate of interest or a participation in a profit sharing agreement, which, like the stock in this case, are specifically enumerated instruments in the statutory definition of "security." 439 U.S. at 558 n.11.

Evaluating the "economic realities" of the underlying transaction, the Court concluded that the pension plan was not a security because: (1) employees did not make "investments," but rather "sold" their labor to obtain a livelihood; and (2) profits were derived primarily from the efforts of employees, the "investors" in the enterprise, rather than from the success of the investment fund. 439 U.S. at 562.

The Court concluded that an extension of the Acts to the pension plan in dispute was not merited by the language or history of the statute. The Court also noted that no "general purpose" would be served by extending coverage to the disputed plan because adequate protection and alternative remedies were available under other legislation governing employee pension plans. 439 U.S. at 569-70.

6. *Marine Bank v. Weaver*, 455 U.S. 551 (1982).

The Court's unanimous decision in *Marine Bank*, removes any doubt about the applicability of the economic realities test to all transactions in which the existence of a security is in question. *Marine Bank* considered whether two instruments, a conventional certificate of deposit and a privately negotiated profit-sharing agreement, constituted a "security." Both of the instruments, like the stock in this case, are specifically listed in the statutory definition of "security."

The Court reconfirmed at the outset that it has "repeatedly held" that the test for whether an instrument is covered under the Acts focuses on the transaction in which the instrument is involved and not on the instrument itself:

[The test] is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.

455 U.S. at 556 (quoting *Joiner*, 320 U.S. at 352-53).

The *Marine Bank* court specifically addressed the meaning of the phrase "unless the context otherwise requires," which precedes the statutory definition of the term "security." 455 U.S. at 556. The Court stated that the "context clause" means that "an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires." 455 U.S. at 556. See Section III.A., *supra*.

In the second half of the *Marine Bank* decision, the Court considered whether a privately negotiated agreement between two parties to share profits from one party's business was a "security." Evaluating the economic realities underlying the agreement, the Court focused on the fact that the agreement was the product of a private rather than a public transaction. Ruling that "a security is an instrument in which there is 'common trading'," the Court concluded that the agreement did not fall within the concept of a "security" because no prospectus was distributed to other potential investors; the terms of the agreement were unique and privately negotiated; and the agreement was not designed to be traded publicly. 455 U.S. at 560 (citing *Joiner*, 320 U.S. at 351). The Court also noted that a provision in the agreement which allowed the non-owners to veto future loans to the owner "gave them a measure of control over the operation of the [business] not characteristic of a security." 455 U.S. at 560. The Court concluded that this "unique agreement, negotiated one-on-one by the parties, is not a security." 455 U.S. at 560.

Finally, in its closing language in *Marine Bank*, the Court unequivocally endorsed its longstanding rule that all disputed instruments must be analyzed in terms of the transaction in which they are involved:

Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole.

455 U.S. at 560 n.11.

**D. An Analysis of the Economic Realities Underlying This Transaction Demonstrates That the Sale of 100% of the Stock of LTC I Was Not a Transaction in Securities.**

As recognized by this Court in *Forman*, the *Howey* test embodies the essential attributes of a "security":

[A]n investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

421 U.S. at 852 (quoting *Howey*, 328 U.S. at 301).

An analysis of the economic realities underlying this transaction demonstrates that the Landreths' sale of 100% of the stock in LTC I to B&D, a corporate purchaser, was not the sale of a "security" because: (1) there was no "common enterprise" between the purchaser and the Landreths; and (2) the purchaser did not expect profits to be derived from the managerial or entrepreneurial efforts of others.

**1. The Sale of 100% of the Stock of LTC I Is Not a Transaction in Securities Because There Is No Common Enterprise Among the Purchaser and the Sellers.**

A "common enterprise" is "one in which the fortunes of the investor are interwoven with and dependent upon the



efforts and success of those seeking the investment or of third parties." *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 n.7 (9th Cir. 1973). Circuit courts disagree regarding the extent to which an investor's fortunes must be interwoven with the success of a promoter in order to constitute a "common enterprise." Some courts require a "sharing or pooling of funds" between the investor and the promoter. See, e.g., *Frederiksen v. Poloway*, 637 F.2d 1147, 1152 (7th Cir. 1981); see also *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 100-01 (7th Cir. 1977). Other courts require only the existence of a relationship between an investor and a broker upon whose expertise the profitability of the investment depends. See, e.g., *S.E.C. v. Continental Commodities Corp.*, 497 F.2d 516, 522 (5th Cir. 1974). The Ninth Circuit requires correlation between the success of the promoter and that of the investors' accounts. See, e.g., *Meyer v. Thomason & McKinnon Auchincloss Kohlmeyer, Inc.*, 686 F.2d 818 (9th Cir. 1982).

This Court has not yet addressed the issue of the extent to which a "common enterprise" requires that the investors' fortunes be tied to those of the promoter. See *Mordaunt v. Incomco*, No. 83-225, slip op. at 3 (U.S. Jan. 7, 1985). Regardless of which view this Court ultimately adopts, however, there is no common enterprise between the purchaser and the seller in the sale of a business through the transfer of 100% of the corporation's stock, because at the time of closing the transfer of ownership is complete and the fortunes of the purchaser subsequently are not interwoven with, or dependent upon, the efforts or success of the seller. See *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d at 482 n.7.

Although the lower courts in this case did not address the issue of whether B&D invested in a "common enterprise"

with the Landreths,<sup>19</sup> at least two other courts of appeals decisions have ruled, under virtually identical facts, that the sale of 100% of the stock of a closely held corporation fails to satisfy the common enterprise element of the "economic realities" test. See *Canfield v. Rapp & Son, Inc.*, 654 F.2d 459, 464 (7th Cir. 1981); *Frederiksen*, 637 F.2d at 1152.

The total absence of a "common enterprise" in the sale of a business to a single corporate purchaser through the transfer of 100% of the corporation's stock is the key factor which distinguishes it from stock sales of less than 100%. In transactions where less than the entire ownership interest is conveyed, there could be a "common enterprise" between the purchaser and the seller or other third parties, depending upon the circumstances of the transaction and the degree to which the purchaser's fortunes are intertwined with the success of the seller or others in the business venture. If a "common enterprise" is found to exist, a court then would have to address the other elements of the "economic realities" test, and decide whether the purchaser reasonably expected profits in reliance upon the managerial or entrepreneurial efforts of others. See Section III.D.2, *infra*.

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<sup>19</sup> Although counsel for the Landreths asserted in pleadings filed with the district court in support of their motion for summary judgment that there was no common enterprise among the Landreths and the purchaser, in applying the "economic realities" test to B&D's purchase of 100% of the stock of LTC I from the Landreths, the district court ruled:

[T]his Court need only determine whether the third requirement has been met, whether the purchasers were led to expect profits from the managerial or entrepreneurial efforts of others.

Appendix B at A-10. The Ninth Circuit focused solely on the third element of the "economic realities" test:

The application of the *Howey* test to the acquisition of a business through purchase of a stock is straightforward: When a person purchases control of a business, he does not make an investment from which he expects profits solely from the efforts of others.

*Landreth Timber Co. v. Landreth*, 731 F.2d 1348, 1352 (9th Cir. 1984).



However, in analyzing whether the sale of 100% of the stock of a closely held corporation to a single purchaser constitutes a "transaction in securities," it is unnecessary for the Court to inquire whether the purchaser intended to manage or control the business because the first requirement of the "economic realities" test, a "common enterprise," has not been met. The fact that a purchaser does not invest in a "common enterprise" with the seller in and of itself removes the transaction from the scope of the federal securities laws. Only if a transaction involves a "common enterprise" is it necessary to reach the next level of inquiry and determine who, among the persons or entities engaged in the common enterprise, manages or controls the investment.

The absence of a "common enterprise" in this transaction presents this Court with an issue of first impression<sup>20</sup> and goes to the heart of why this transaction is not a "transaction in securities." Because there is no common enterprise or pooling of funds in the sale of 100% of a corporation's stock, the transaction falls outside the intent and purpose of the Acts.

**2. *The Sale of 100% of the Stock of LTC I Is Not a Transaction in Securities Because The Purchaser Did Not Have an Expectation of Profits to Be Derived From the Entrepreneurial or Managerial Efforts of Others.***

The legislative history of the Acts exhibits a Congressional intent to protect those investors who provide venture capital to promoters but remain dependent

<sup>20</sup> The transaction at issue herein presents this Court with the first case in which the common enterprise element of the economic realities test has not been met. All of the Court's prior decisions defining a "security" have involved transactions in which the existence of a "common enterprise" was neither disputed by the parties nor specifically addressed by the Court.

upon others for the management and outcome of their investment. See Section III.B, *supra*. This aspect of the economic realities test has been carefully developed in the precedential analysis of this Court. See Section III.C, *supra*. It is a critical aspect of the economic realities test that the investment be "premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975). When a purchaser acquires complete ownership of a business through the purchase of 100% of a corporation's stock, such purchaser has an unfettered right to manage and control the business. Thus, in adopting the sale of business doctrine, a number of courts have held that acquisition of an entire business through the purchase of its stock does not constitute a "security" under the Acts.<sup>21</sup>

The requirement of the Acts that a purchaser rely on the efforts of others for his profits has been repeatedly emphasized by this Court. In *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946), the Court noted that the promoter's management, control and operation of the enterprise was a significant element of a "profit-seeking business venture." 382 U.S. at 300.

In *Tcherepnin v. Knight*, 389 U.S. 332, 345 (1967), the Court emphasized that investors in a savings and loan association required the protection of the Acts because they "had to rely completely on City Savings' management to choose suitable properties on which to make mortgage loans..." citing *Tcherepnin v. Knight*, 371 F.2d 374, 384 (7th Cir. 1967).

In *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852-53 (1975), the Court found that when a purchaser is motivated by a desire to use or consume the asset purchased, i.e., when the subject of the purchase is within the buyer's own control, the Acts do not apply.

<sup>21</sup> See n. 15, *supra*.

Similarly, in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 561-62 (1979), the Court concluded that a compulsory, non-contributory pension plan was not a security because the majority of income in the plan was the result of employer contributions, a source which was not dependent upon the efforts of the fund's managers. Thus, the employees were not investors who were relying to any substantial degree on the efforts of others for an expectation of profits.

Finally, in *Marine Bank*, 455 U.S. at 551, 560 (1982), this Court decided that the transaction did not involve a security because a privately negotiated profit-sharing agreement gave the investors a right to use some of the facilities of the business and the authority to veto loans. Thus, the investors had "a measure of control over the operation of the [business] not characteristic of a security." *Id.*

In the case now before the Court, LTC II obtained and exercised complete corporate control over the business which it acquired from the Landreths. In its admissions of fact before the district court, LTC II conceded that it acquired 100% of the stock of LTC I at closing, and that none of the Landreths became officers, directors, shareholders or employees of the purchasing entity (J.A. 182, 184, 204). Pursuant to the Stock Purchase Agreement, the Landreths resigned as officers and directors of LTC I, and had no right to share in the profits or losses of LTC II (J.A. 186, 204). Prior to closing of the sale, the purchaser selected and retained its own mill manager who assumed this position immediately upon closing (J.A. 186-188). After the sale of the business, Ivan Landreth's role was limited to that of a consultant who was terminable at will. Within two months after the date of sale, LTC II terminated Landreth (J.A. 189-90, 201, 309).

LTC II suggests in its brief that Landreth and Cook, LTC II's own mill manager, are "others" with whom the purchaser invested in a common enterprise and from whose efforts it expected profits. See, e.g., Pet. Br. at 8-9, 42. The admitted

facts establish, however, that Landreth had no control over the business after closing of the sale (J.A. 191-98). Moreover, both Landreth<sup>22</sup> and Cook remained under the ultimate control of the purchaser. Within the context of a securities transaction, the term "others" means persons or entities beyond the control of the purchaser. *Bitter v. Hoby's International, Inc.*, 498 F.2d 183, 186 (9th Cir. 1974). Employees or consultants retained by the purchaser are not beyond the purchaser's control and, therefore, are not "others" within the meaning of the economic realities test. As the *Bitter* court stated:

For the manager to be a "third party," within the meaning of the [economic realities] test, the manager must be outside of the direct and immediate control of the franchisee.

498 F.2d at 186. See *Landreth Timber Co. v. Landreth*, 731 F.2d 1348, 1353 (9th Cir. 1982); see also *Frederiksen*, 637 F.2d at 1152 (rejecting purchaser's argument that seller's continued employment as "consultant," including right to receive commissions and a share in profits, constituted a "sharing or pooling of funds").

In summary, for many of the same reasons that there was no "common enterprise" among sellers and purchaser in this transaction, there also was no purchaser reliance upon an expectation of profits to be derived from the entrepreneurial or managerial efforts of "others." As the Ninth Circuit correctly stated:

Following the transaction, Landreth II had full control of the corporation, including the day-to-day operations of the mill and its employees. In "economic reality," the underlying transaction was a sale of a

<sup>22</sup> Landreth was retained as a consultant for only two months after closing. His functions and ability to affect the business were negligible and were totally within the control and discretion of the purchaser (J.A. 188, 191-98).



lumber business and, under the sale-of-business doctrine, was not an investment in a "security."<sup>23</sup>

*Landreth Timber Co. v. Landreth*, 731 F.2d at 1353.

**E. Policy Considerations Favor the Continued Application of the Economic Realities Test in Determining Whether a Transaction Constitutes a Security Within the Scope of the Acts.**

**1. Consistency in Application of the Securities Laws Requires Continued Adherence to the Economic Realities Test.**

In a series of decisions spanning the past forty-two years, this Court consistently has analyzed the economic realities of the underlying transaction in determining whether a transaction involved a "security" subject to the Acts. See Section III.C., *supra*. In these decisions the Court has had no difficulty in applying the economic criteria of *Howey* and *Forman* to transactions involving a variety of specifically enumerated instruments under the Acts.

It is against this precedential background that the Court must analyze LTC II's argument that the economic realities test should be discarded, and a "traditional characteristics" test should be applied, in order to determine whether the sale of all of the stock of a business is a transaction in securities.

The "traditional characteristics" test, as advocated by LTC II, has *never* been applied by this Court. This Court only has noted that the existence of traditional characteristics of an enumerated instrument under the Acts "may" or "might" be helpful in making a determination regarding the existence of a transaction in securities. *United Housing*

<sup>23</sup> The court further stated that the "uncontested facts belie" the assertion that purchaser was somehow dependent on Ivan Landreth. The court emphasized that LTC II had hired its own mill manager who assumed effective control of the business and that Landreth's services as a consultant were terminable at the will of LTC II. The court concluded that neither Landreth nor LTC II's manager could be regarded as a third-party on whose efforts the purchaser relied for its expectation of profit. 731 F. 2d at 1353.

*Foundation, Inc. v. Forman*, 421 U.S. 837, 850 (1975). Nevertheless, in each of its decisions the Court has decided to employ a transactional analysis in determining the existence of a security. See Section III.C., *supra*.

Given the Court's endorsement of the economic realities test in a variety of transactional contexts, the application of LTC II's proposed "traditional characteristics" test would create the anomaly of applying a variety of conflicting standards to the various instruments listed under the Acts. If the Court adopts the literal approach proposed by LTC II and the S.E.C. for determining whether "stock" is a security, it inevitably will be required to create a variety of specialized tests for the instruments enumerated in the Acts, including the following:

- (1) A "traditional characteristics" test which would be applied to certain "typical" instruments, including stock<sup>24</sup> and other undetermined instruments. This test would focus on the form of the instrument irrespective of its transactional context.
- (2) The economic realities test of *Howey* and *Forman* which, according to LTC II, would apply to an analysis of certain "atypical" instruments and investment contracts;<sup>25</sup>
- (3) An "overriding federal regulation" test which would disregard the first two tests, excluding certificates of

<sup>24</sup> Contrary to LTC II's assertion, the "stock" at issue here did not possess all of the traditional characteristics ordinarily associated with stock under the Acts. LTC I was a closely held family business, and thus the negotiability of the shares was limited. There were no regular meetings, and no dividends were declared (R. 70 at 2). Furthermore, the stock on transfer to B&D, lacked what this Court has deemed to be the "most common feature of stock: the right to receive 'dividends contingent upon an apportionment of profits.'" *Forman*, 421 U.S. at 851 (citing *Tcherepnin*, 389 U.S. at 339). LTC II's profits were "contingent" only upon the success or failure of its own managerial efforts. Thus, even under LTC II's formulation of the traditional characteristics test, the stock at issue was "atypical," requiring a review of the economic realities underlying the transaction.

<sup>25</sup> Note that LTC II cannot attack the viability of the economic realities test given its repeated application by this Court. LTC II can only attempt to restrict its application, arguing that such test applies only to investment contracts or "atypical" instruments. Pet. Br. at 27.



deposit and perhaps other instruments from the application of the Acts, presumably based upon the intensity and extent of federal regulation over such instruments. See the S.E.C.'s labored attempts to distinguish *Marine Bank v. Weaver*, 455 U.S. 551 (1982). S.E.C. Br. at 19-20; and

- (4) Various other tests, which presumably would have to be created and applied to instruments depending upon their innate characteristics or the circumstances of their use.<sup>26</sup>

The creation of such diverse tests would conflict with this Court's expressed affirmation that certain common essential attributes run through all of its decisions defining a security. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975).

Moreover, the definitional sections of the Acts do not readily submit to application of the proposed "traditional characteristics" test. Many instruments which appear on their face to be instruments listed in the Acts are not securities. For example, the term "note" is included within the statutory definition of a "security," and yet it would be preposterous to suggest that every document which has all of the traditional characteristics of a "note" necessarily constitutes a "security".<sup>27</sup>

<sup>26</sup> See *Ruefenacht v. O'Halloran*, 737 F.2d 320, 324-25 (3d Cir. 1984) in which the Third Circuit, in rejecting the sale of business doctrine, implicitly recognized the resulting need for different analyses in order to determine whether instruments entitled "stock," "notes" and "commercial paper" constituted a "security" under the Acts.

<sup>27</sup> Courts routinely refer to economic realities in determining whether a "note" is to be considered a "security." See, e.g., *Chemical Bank v. Arthur Anderson & Co.*, 726 F.2d 930 (2d Cir. 1984); *National Bank of Commerce v. All American Assurance Co.*, 583 F.2d 1295 (5th Cir. 1978); *Exchange National Bank v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976); *Emisco Industries, Inc. v. Pro's Inc.*, 543 F.2d 38 (7th Cir. 1976); *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976); *McClure v. First National Bank of Lubbock*, 497 F.2d 490 (5th Cir. 1974); *Bellah v. First Nat'l Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974); *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973).

The "traditional characteristics" test, by proposing that the Court focus entirely on the form of the instrument in determining the existence of a security, disregards the intent of the Acts which were designed to protect investors of venture capital who become involved in enterprises managed by others, leaving such investors with little or no control over the outcome of their investment. See Section III.B., *supra*. The proposed "traditional characteristics" test ignores the repeated focus of this Court on the economic realities of the underlying transaction in order to determine whether it includes a security within the purpose and intent of the Acts.

## 2. The S.E.C.'s Positions Regarding the Existence of a "Security" Under the Acts Are Inconsistent And Have Been Rejected by This Court.

It is interesting to note that approximately 38 years ago, the S.E.C. argued in favor of the position which now forms part of the basis of the economic realities test. In *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946), the S.E.C. contended:

[T]hat the ruling of the Circuit Court of Appeals [affirming a denial of the S.E.C.'s attempt to enjoin a scheme as a violation of the 1933 Act] conflicted with other federal and state decisions and that it introduced a novel and unwarranted test under the statute which the Commission regarded as administratively impractical.

328 U.S. at 294.

In *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), the Court stated that it was not the S.E.C.'s role to determine the extent of federal jurisdiction:

Although these limits [of how far an agency may go in interpreting a statute] are not always easy to discern, it is clear here that the SEC's position is neither long-standing nor even arguably within the outer limits of its authority to interpret these Acts.

439 U.S. at 566 (footnote omitted). The Court stressed that on a number of prior occasions it had been necessary to reject the S.E.C.'s interpretation of various provisions of the Acts. 439 U.S. at 566 nn.20-22.

While campaigning in lower courts for a traditional characteristics approach to defining "securities" in sale of business cases, the S.E.C., as *amicus*, took the opposite position in *Marine Bank*, supporting an approach which ultimately excluded certain certificates of deposit from the coverage of the Acts based upon the transactional context.<sup>28</sup>

455 U.S. at 557. Moreover, in a case currently under review by the Second Circuit involving the question of whether "notes" are securities under the Acts, the S.E.C. again apparently has endorsed a "transactional context" approach. *S.E.C. v. American Board of Trade*, 16 Sec. Reg. & L. Rep. (BNA) 1921-22 (Dec. 7, 1984).

In summary, given the S.E.C.'s historic inconsistency in interpreting the Acts,<sup>29</sup> and the inherent limitations on the scope of its interpretative powers, the federal courts, not the S.E.C., are the appropriate forum for a determination of the applicability of the Acts to the sale of a business.

<sup>28</sup> The S.E.C.'s *amicus* brief in *Marine Bank v. Weaver* conceded, among other things, that the analysis of the economic context required by the securities laws included "the surrounding factual circumstances," and recognized that the Acts were designed to help investors, not entrepreneurs such as the plaintiff in *Marine Bank*. S.E.C. brief in *Marine Bank v. Weaver* at 8, 18.

<sup>29</sup> The S.E.C.'s position also has been inconsistent within given types of instruments. In *Marine Bank v. Weaver*, 455 U.S. 551 (1982) the Court noted that the S.E.C. had taken the position in other proceedings that certificates of deposit constituted securities. The S.E.C. brief in *Marine Bank*, however, urged the opposite position, arguing that the Weavers' certificate of deposit was not a security. 455 U.S. at 557 n.6.

### 3. The "Sale of Business Doctrine" Reduces, Rather Than Expands, the Burden on the Federal Judiciary.

#### a. Congress Did Not Intend the Acts To Provide a Remedy for All Types of Alleged Fraud and Misrepresentation.

There is no identifiable federal interest in applying the Acts to instances of alleged fraud and misrepresentation where there is neither: (1) a common enterprise between the purchasers and the sellers of a business, nor (2) investors who are dependent upon the efforts of others for their expectation of profits. The Acts reflect a Congressional intent to provide a remedy for investors who, without the ability to control the outcome of their investment, provide venture capital to promoters who control and manage the business. See Section III.B., *supra*.

As this Court stated in *Marine Bank*:

[W]e are satisfied that Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud. *General Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1253 (C.A. 9 1976); *Bellah v. First National Bank*, 495 F.2d 1109, 1114 (C.A. 5 1974).

455 U.S. at 556.

Investors in commercial transactions outside of the Acts will continue to have a remedy under state law for alleged fraud or misrepresentation.<sup>30</sup> However, it is both unnecessary and improper for the federal judiciary to extend the protection of the Acts to entrepreneurs who purchase all of the stock of a closely held corporation, particularly where the purchase of stock is merely an alternative method of acquiring the assets of the business.

<sup>30</sup> An entrepreneur who purchases 100% of the stock of a business inherently has considerable leverage to obtain the disclosure of information, warranties, and other contractual protections against fraud. Such an investor also has substantial ability to provide contractual remedies in the event fraud occurs. In this case LTC II negotiated extensive warranties for its own protection and then coerced the Landreths into substantially increasing amounts placed into an escrow fund as a condition of receiving a further installment on the purchase price. (R. 69 at 64-69).



**b. Continued Application of the Economic Realities Test Will Properly Limit the Involvement of the Federal Judiciary in Transactions Involving the Sale of an Entire Business: Federal Courts Can Apply the Economic Realities Test in a Fair and Predictable Manner.**

LTC II and the S.E.C. both argue that application of the sale of business doctrine will increase the burden on federal courts. They fail to appreciate that the economic realities test is a limitation on, not an expansion of, federal jurisdiction. Consequently it is difficult to conceive how this test would increase the burden on federal courts. On the contrary, rejection of the sale of business doctrine in the *Landreth* case, and an adoption of the proposed "traditional characteristics" test, necessarily would begin a new wave of federal securities litigation, ultimately requiring this Court to decide what instruments are subject to the "traditional characteristics" test; what transactions are subject to the "economic realities" test; what instruments are excluded from either test because of the extent of federal regulation; and what other tests, if any, should apply to other instruments enumerated in the definitional sections of the Acts. Thus, the adoption of the "traditional characteristics" test with respect to "stock" will guarantee a substantial additional period of appellate controversy.

Moreover, application of the economic realities test to the sale of a business allows federal district courts to dispose of a number of cases by way of summary judgment, thereby avoiding lengthy and complex trials. In a summary judgment setting, a federal court is concerned only with deciding whether the criteria of the economic realities test are met, including a determination of whether there has been an investment of money in a common enterprise, with an expectation of profits to come from the efforts of others. In a situation involving the sale of 100% of a corporation's stock, such as the sale of LTC I, there is no "common enterprise," and the issue can be decided as a matter of law. Moreover, where all of the stock of a business is sold to a purchaser who assumes complete control over the outcome of his investment

there is no reliance on the managerial efforts of others and, as a matter of law, dismissal of federal securities claims is equally appropriate. See *Landreth Timber Co. v. Landreth*, 731 F.2d 1348, 1353 (9th Cir. 1984).

Even in instances where less than 100% of the stock is acquired by a purchaser, and where a common enterprise may be determined to exist, a district court can hear evidence regarding the extent of the purchaser's control over the business, and thereafter can make a reasoned decision regarding the existence of federal claims without the necessity of a lengthy and complex securities fraud trial. In such a hearing it would be unnecessary to consider evidence of alleged fraud, related causes of action, pendent claims, and damages, all time-consuming elements of a federal securities fraud trial. Application of the sale of business doctrine will prevent an excessive number of cases from being brought in federal court which, in reality, involve the purchase of businesses by entrepreneurs for whom Congress never intended special protection. Thus, the economic realities test remains a workable common sense approach for applying the Acts consistent with their purpose.

#### IV. CONCLUSION

The decision of the Ninth Circuit Court of Appeals should be affirmed.

DATED this 4th day of February, 1985.

Respectfully submitted,

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## APPENDIX A

### References to Record

<u>Document Title</u>	<u>Document No. In Record</u>	<u>Page Within Document</u>	<u>Page of Brief</u>
Jack Branch deposition transcript, p. 23, App. B to Affidavit of James A. Smith, Jr., filed September 25, 1980 ("Smith Aff.")	R.69	242	3
Ivan Landreth letter to Gene Graf, App. B to Affidavit of John W. Hathaway, dated November 7, 1980	R.93	157	3
Article from Forbes, App. A to Smith Aff.	R.69	5	3
Dennis deposition transcript, p.3, App. B to Smith Aff.	R.69	141	3
LTC I listing of business, App. B to Affidavit of John W. Hathaway, dated November 7, 1980	R.93	158	3n.6
Affidavit of Ivan K. Landreth ¶ 5, filed September 25, 1980	R.70	2	3n.6
Dennis deposition transcript, p. 50-51, App. B to Smith Aff.	R.69	174-75	3n.7
Branch deposition transcript, p. 28-29, App. B to Smith Aff.	R.69	244-45	3n.7

Document Title	Document No. In Record	Page Within Document	Page of Brief
Dennis deposition transcript, at 97 and 107, App. B to Smith Aff.	R.69	181-82	4
Dennis deposition transcript at 25, 46, 50-51, 53-54, Robert M. Ingram deposition transcript at 83-85, 135-36, App. B to Smith Aff.	R. 69	161, 171 174-75, 179-80, 310-14	4
Appraisal Report, Landreth Timber Company, Inc., App. A to Smith Aff.	R.69	93-122	4
Dennis deposition transcript at 14-20, 422-23, App. B to Smith Aff.	R.69	152-58 228-29	4
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## APPENDIX B

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

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No. C78-663R

LANDRETH TIMBER COMPANY, INC.,  
*Plaintiff,*

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
and KATHLEEN LANDRETH, husband and wife,  
*Defendants.*

IVAN K. LANDRETH AND LUCILLE LANDRETH, husband and  
wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR.  
and KATHLEEN LANDRETH, husband and wife,  
*Counterclaim Plaintiffs,*

v.

LANDRETH TIMBER COMPANY, INC.,  
*Counterclaim Defendant.*

---

ORDER GRANTING SUMMARY JUDGMENT

THIS MATTER comes before the Court on cross-motions for summary judgment. Oral argument was heard on February 27, 1981. At the conclusion of that hearing, the Court indicated its inclination to grant summary judgment in favor of the defendants and asked counsel to submit a list of admitted facts bearing on the issue of

managerial control. Subsequent to the hearing, counsel submitted admitted facts and supplemental memoranda regarding managerial control. Counsel for the plaintiff also filed a motion for reconsideration. On April 17, 1981, the Court heard argument on the issue of managerial control. Having considered the motions, memoranda, affidavits, admitted facts, and being fully advised, the Court now finds and rules as follows:

This is an action by the plaintiff Landreth Timber Company to recover for violations of the federal securities laws,<sup>1</sup> state securities laws and state common law. The issue presented is whether the sale of 100% of the stock of a closely-held corporation is a transaction covered by the federal securities laws. This Court joins a growing majority in holding that the federal securities laws do not apply.

Summary judgment is proper where there is no genuine issue of material fact or where viewing the evidence and the inferences which may be drawn therefrom in the light most favorable to the adverse party, the movant is clearly entitled to prevail as a matter of law. *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1254 (9th Cir. 1976); *Marx v. Computer Services Corp.*, 507 F.2d 485, 487 (9th Cir. 1974). A factual issue is immaterial if resolution of the issue is not necessary in order for the court to reach its decision. *Cordas v. Speciality Restaurants, Inc.*, 470 F. Supp. 780 (D. Ore. 1979).

The material facts in this case are undisputed. The defendants sold 100% of the stock of the Landreth Timber Company to the plaintiff's predecessor-in-interest. The stock possessed the ordinary characteristics of stock.

<sup>1</sup> Section 12(1), 12(2), and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77l(1), 77l(2) and 77q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5 of the Securities Exchange Commission, 17 CFR § 250.10b-5.

The two principal financial backers behind the purchase, Samuel S. Dennis and John Bolten Sr., were not knowledgeable in any aspect of the lumber industry.

Prior to closing the transaction, the purchasers retained Phil Cook to be general manager of the mill after closing. On the closing date, November 17, 1977, two agreements were entered into: (1) a stock purchase agreement which transferred 100% of the stock and required the defendants to deliver to the purchasers the signed resignations of all the officers and directors of the Landreth Timber Company, and (2) a consulting agreement between Ivan K. Landreth Sr. and the purchasers. The nature and scope of Landreth's post-closing role as consultant was defined in the consulting agreement as follows:

1.2 *Consulting Duties, Etc.* The Company shall employ the consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as a consultant to the Company in connection with such participation and for such purposes.

Pursuant to this agreement, Landreth's role was purely advisory; the authority to make any and all managerial decisions was transferred to Phil Cook and, ultimately, to the purchasers. The consulting agreement also provided that Landreth's post-closing employment was terminable by plaintiff at will upon thirty days' prior written notice.

Subsequent to closing the transaction, it allegedly became apparent that numerous misrepresentations had been made by the defendants during the course of nego-



tiations. The plaintiff terminated the consulting agreement with Landreth and filed this action.

The threshold issue in this case is whether the stock involved is a "security." The parties agree that a transaction evidenced by the sale of stock is not necessarily a security transaction simply because the statutory definition of a security includes the words "any . . . stock." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 848 (1974). Rather, the courts adhere to the principle that "in searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

What, then, are the relevant "economic realities" that must be examined? How closely should a court examine a stock before determining whether it is a "security"? It is here that the parties differ. The plaintiff contends that the Court should constrain itself to examining the characteristics of the stock itself. The plaintiff points out that Landreth stockholders have the following rights: receiving notice of any shareholders' meeting; electing and removing directors and filling vacancies; receiving certificates representing their ownership interest; transferring shares to a third party; receiving declared dividends; amending by-laws; and all rights granted to shareholders by Washington law. The plaintiff argues that these traditional characteristics of stock would lead a reasonable purchaser to assume that the securities laws would apply and, therefore, the Court should look no further.

The defendants, on the other hand, urge the Court to look beyond the characteristics of stock to the economic realities of the underlying transaction. They contend that the transaction at issue was essentially the sale of a business, through the transfer of stock, and that such a transaction is not within the purview of the federal securities laws.

This issue can be resolved only after a careful reading of the Supreme Court's decision in *Forman, supra*. In *Forman*, residents of a cooperative housing project, who had been required to purchase "stock" in the housing cooperative in order to acquire a residential unit, filed an action for fraud under the federal securities laws. The Court held that the shares of stock did not constitute "securities" within the meaning of those laws.

In part "A" of the *Forman* opinion, the Court rejected the argument that a transaction, evidenced by the sale of shares called "stock," must be considered a security transaction simply because the statutory definition of a security includes the words "any . . . stock." 421 U.S. at 848. In doing so, the Court emphasized the purposes underlying the federal securities laws.

The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. 421 U.S. at 849.

The Court concluded that the "stock" before it was not a "security" within the meaning of the federal securities laws. In doing so, the Court relied both on the fact that the shares did not possess the characteristics traditionally associated with stock (e.g. no dividends, no right to pledge or hypothecate, no voting rights), and on the fact that the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit. 421 U.S. at 851.

In part "B" of the opinion, the Court rejected the Court of Appeals' conclusion that a share in the housing

cooperative was an "investment contract" as defined by the Securities Acts, and rejected the plaintiffs' further argument that in any event what they agreed to purchase is "commonly known as a 'security'" within the meaning of those laws. The Court stated:

In considering these claims we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a 'security'." In either case, the basic test for distinguishing the transaction from other commercial dealings is

"whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301.

This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. 421 U.S. at 852.

Three aspects of the above-quoted passage should be noted in particular. First, the Court states that "we again must examine the substance—the economic realities of the transaction. . . ." (emphasis added). This is a further indication that the Court in part "A" was looking to the economic realities of the underlying transaction, and not simply examining the characteristics of the stock instruments themselves. Second, the Court indicates a distinction between security transactions and "other commercial dealings." As the Court states later in the same paragraph, in a securities transaction the investor is attracted solely by the prospect of a return on his investment. 421 U.S. at 852.

By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or develop it themselves" as the *Howey* Court put it, *ibid.*—the securities laws do not apply. 421 U.S. at 852-53.

Finally, it should be noted that the Court states that the *Howey* test "embodies the essential attributes that run through all of the Court's decisions defining a security." (emphasis added). This is a strong indication that the Court intends that the *Howey* test be generally applicable to all cases where the meaning of "security" is at issue, not just cases involving the definition of "investment contract." This conclusion is further supported later in the *Forman* opinion where the Court states:

What distinguishes a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others. . . . 421 U.S. at 858.

For these reasons, this Court concludes: (1) that it must look beyond the characteristics of the stock itself to the economic realities of the underlying transaction, (2) that it must bear in mind a distinction between security transactions and other commercial dealings, and (3) that the *Howey* test focuses on the relevant "economic realities" and is applicable in determining whether a stock transaction is within the purview of the federal securities laws. These conclusions comport with the majority of post-*Forman* decisions. *Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir. 1981); *Chandler v. Kew*, Fed. Sec. L. Rptr. ¶ 96,966 (10th Cir. 1977); *Bula v. Mansfield*, Fed. Sec. L. Rptr. ¶ 96,964 (D. Col. 1977); *Dueker v. Turner*, Fed. Sec. L. Rptr. ¶ 97,535 (D. Geo. 1979); *Anchor-Darling Industries v. Leonard Suozzo*, No. 79-4085, E.D. Penn, March 16, 1981; *Barsy v. Verin*, No. 79 C 3323, N.D. Ill., February 25, 1981. But see *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir. 1979); *Titsch Printing, Inc. v. Hastings*, 456 F. Supp. 445 (D. Col.



1978); *Bronstein v. Bronstein*, 407 F. Supp. 925 (E.D. Penn 1976).

In applying the *Howey* test, this Court need only determine whether the third requirement has been met, whether the purchasers were led to expect profits from the managerial or entrepreneurial efforts of others. This determination must be made based on the factual circumstances at the time of the agreement and not on facts occurring subsequent to the agreement. *El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1228 (9th Cir. 1974). It also irrelevant for the purchasers to argue that they relied on Landreth's past efforts to build up the business. As the Seventh Circuit stated in *Enisco Industries v. Pro's Inc.*, 543 F.2d 38 (7th Cir. 1976):

This only repeats plaintiffs' allegation of reliance upon misrepresentations made during the purchase. The important element for the transaction to constitute an investment is that [the purchaser] relied on the present and future efforts of another to produce profits. 543 F.2d at 41.

Thus, events occurring prior to the agreement are relevant only insofar as they indicate whether the purchasers, as of the date of the agreement, were led to expect profits resulting from the future entrepreneurial or managerial efforts of others.

The purchasers argue that the third requirement of *Howey* has been met because they were led to expect profits from the efforts of Landreth and Cook. In other words, the purchasers argue that Landreth and Cook are "others" for purposes of the third requirements of the *Howey* test.

This argument exalts a literal reading of the *Howey* test over the purposes of the federal securities laws. The fundamental purpose of those laws is to protect those who place their money in the hands of someone over whom they exercise little or no control. Persons or entities who are beyond the control of the purchaser are

"others" within the meaning of *Howey* and *Forman*. Employees, including managers and consultants, are not. *Bitter v. Hoby's International Inc.*, 498 F.2d 183 (9th Cir. 1974). In the words of the Ninth Circuit in *Bitter*:

For the manager to be a "third party," within the meaning of the *Howey* test, the manager must be outside of the direct and immediate control of the franchise. 498 F.2d at 186.

In the present case, both Landreth and Cook, as employees, were under the direct and immediate control of the purchasers after the sale and, therefore, they are not "others" or "third parties" within the meaning of *Howey* and *Forman*. Because there are no "others" involved in this case, it is not necessary to apply the analysis in *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973).<sup>2</sup>

For these reasons, the motion for reconsideration is DENIED and the defendants' motion for summary judgment is GRANTED.

IT IS SO ORDERED.

The Clerk of this Court is directed to send uncertified copies of this Order to all counsel of record.

DATED at Seattle, Washington, this 29th day of April, 1981.

/s/ Barbara J. Rothstein  
United States District Judge

<sup>2</sup> In *Turner*, the promoter/seller was beyond the control of the purchasers and, therefore, it was an "other" or "third party" within the meaning of *Howey*. This made it necessary to analyze whether the undeniably significant efforts were those of the purchasers or those of the promoter. But, in the present case, Landreth and Cook are not "others" because they were within the control of the purchasers and, therefore, there is no occasion to analyze whether the undeniably significant decisions were made by Landreth, Cook, or the purchasers.



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No. 83-1961

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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1984

LANDRETH TIMBER COMPANY,  
*Petitioner,*  
v.

IVAN K. LANDRETH, LUCILLE LANDRETH,  
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
and KATHLEEN LANDRETH,  
*Respondents.*

On Writ of Certiorari to the United States  
Court of Appeals for the Ninth Circuit

**REPLY BRIEF OF PETITIONER**

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1984

No. 83-1961

LANDRETH TIMBER COMPANY,  
 v. *Petitioner,*  
 IVAN K. LANDRETH, LUCILLE LANDRETH,  
 THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,  
 and KATHLEEN LANDRETH,  
*Respondents.*

On Writ of Certiorari to the United States  
 Court of Appeals for the Ninth Circuit

REPLY BRIEF OF PETITIONER

INTRODUCTION

This brief is submitted in reply to the brief of the respondents, and to the brief of the *amicus curiae* Advance Ross Corporation.

ARGUMENT

I. CONGRESS DID NOT INTEND THAT A SINGLE DEFINITION APPLY TO THE DISPARATE INSTRUMENTS LISTED IN THE DEFINITIONAL SECTIONS OF THE 1933 AND 1934 ACTS.

Central to the respondents' and *amicus* Advance Ross Corporation's ("ARC") arguments, and to the decision below, is the proposition that to fall within the definition of "security" every instrument must meet the test developed in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), to determine the existence of an investment contract. Respondents' Brief at 16-25; ARC Brief at 29; *Landreth Timber Company v. Landreth*, 731 F.2d 1348, 1352 (9th



Cir. 1984).<sup>1</sup> As we demonstrated in our opening brief at 24-35, neither the structure of the definitional sections of the Acts, 15 U.S.C. §§ 77b(1) and 78c(a)(10), well-settled canons of statutory construction, nor this Court's prior decisions permit the imposition of the test developed for "'securities' of a more variable character, designated by such descriptive terms as . . . 'investment contract'" upon the definition of "the commonly known documents traded for speculation or investment." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 297 (1946). Indeed, adopting respondents' and ARC's argument that each instrument listed in the definitional sections must meet the investment contract test would be inconsistent with this Court's recognition in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943), that the general terms such as "investment contract" were intended to expand, not to limit, the types of securities to which the Acts applied.<sup>2</sup>

Even the Seventh Circuit, the architect of the "sale of business doctrine," has concluded that the investment contract test cannot properly be applied to the other instruments listed in the definitional sections of the Acts. In *Hunssinger v. Rockford Business Credits, Inc.*, 745 F.2d 484, 492 (7th Cir. 1984), the Seventh Circuit rejected the argument that a note must meet the definition of an

<sup>1</sup> Specifically, the Ninth Circuit held "the sale of business doctrine and the risk capital test . . . include a transaction only if it involves 'an investment in a common enterprise with profits to come solely from the efforts of others,'" quoting *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).

<sup>2</sup> *Amicus* ARC dismisses as "erroneous" the argument that its application of the "economic realities" or investment contract test to all categories of securities "would blur traditional differences between the categories of securities enumerated by Congress." ARC Brief at 29. ARC asserts that even after the "economic realities" test is applied "each type of security retains its special attributes (e.g., stocks are equity investments, bonds are secured debt investments, notes are unsecured debt investments, etc.) . . ." *Id.* Missing from that argument is any explanation of what difference those "special attributes" would make to the application of the securities laws, or why Congress would twice have bothered to list the securities possessing those special attributes.

investment contract to qualify as a "security." The court held:

The investment contract test determines whether a particular instrument is an "investment contract," a distinct term in the definitional sections of the securities acts. An instrument that fails to satisfy all four requirements of the investment contract test may still fall under one of the other statutory terms in the definitional sections and hence be subject to the substantive provisions of the acts.

*Hunssinger*, 745 F.2d at 492.<sup>3</sup>

Not only do respondents err in asserting that the investment contract test should be applied to determine whether traditional common stock is a "security," but they also premise their argument on the untenable assertion that:

The fact that a purchaser does not invest in a "common enterprise" with the seller in and of itself removes the transaction from the scope of the federal securities laws.

Respondents' Brief at 28. Application of such a purported requirement of a post-sale continuing "common enterprise" between purchaser and seller would substantially rewrite the securities laws. For example, it would exclude from the protection of the securities laws the garden variety transaction in which a shareholder employs a misrepresentation to sell all his stock in a corporation he never has controlled. After such a sale, there surely would be no "common enterprise" between the

<sup>3</sup> *Amicus* ARC also suggests that it is "well established that instruments which are securities when offered in an investment context cease to be securities when transferred in a commercial context." ARC Brief at 20. None of the cases it cites for this "well established" principle hold that the same instrument can be a security when issued, but lose that status when transferred. Furthermore, this Court has itself rejected such a variable treatment of a security. See *Marine Bank v. Weaver*, 455 U.S. 551, 559 n.9 (1982) ("We reject respondents' argument that the certificate of deposit was somehow transformed into a security when it was pledged, even though it was not a security when purchased.").

seller and his defrauded purchaser. Similarly, respondents' argument would exclude the promoter who sells in a public offering all the stock in his corporation. Again, after the successful offering there would be no continuing "common enterprise." Indeed, respondents' argument would exclude a successful tender for 100% of the stock of a publicly traded corporation because, again, there would be no continuing "common enterprise" between the purchaser and seller. Yet the Williams Act, 15 U.S.C. §§ 78l(i), 78m(d), 78m(e), 78n(d)-78n(f), was enacted to apply to just such transactions in "securities."

No argument which produces such illogical, and so clearly unintended, results should be permitted to alter the plain words of the definitional sections of the 1933 and 1934 Acts. The invitation to import the description of an investment contract into the definition of "stock" must be rejected.

## II. NOTHING IN THE LEGISLATIVE HISTORY OF THE 1933 AND 1934 ACTS SUGGESTS THAT THE 1933 AND 1934 ACTS WERE PASSED FOR THE EXCLUSIVE BENEFIT OF "PASSIVE INVESTORS."

Respondents and ARC cull various passages of the legislative history of the 1933 and 1934 Acts to demonstrate that Congress was concerned with protecting "passive investors." Respondents' Brief at 13-15; ARC Brief at 15-18. They then leap to the unwarranted conclusion that Congress was *not* concerned with protecting any other class of persons who bought or sold securities. Indeed, ARC appears to assert that to find that Congress intended to protect non-passive investors would result in "an expansion of the scope of the federal securities laws—with an accompanying displacement of contractual remedies." <sup>4</sup> ARC Brief at 18.

<sup>4</sup> ARC's suggestion that rejecting the "sale of business doctrine" would *expand* the scope of the federal securities laws is curious. As we demonstrated in our opening brief, for more than forty-five years after the passage of the Acts no court had suggested that ordinary common stock was not a security. Petitioner's Brief at 24.

That argument fails as a matter of logic and founders on the legislative history. To be sure, Congress desired to protect small, passive investors, and providing such protection was a major impetus for the Acts. But citation of a series of passages from the legislative history evidencing that intent does not suggest that Congress *rejected* the application of the securities laws to persons who were not small, passive investors. Instead, there is considerable evidence that Congress' intent was not so narrow as respondents and *amicus* assert. As this Court observed in *United States v. Naftalin*:

While investor protection was a constant preoccupation of the legislators, the record is also replete with references to the desire to protect ethical businessmen. See 77 Cong. Rec. 2925 (1933) (remarks of Rep. Kelly); *id.*, at 2983 (remarks of Sen. Fletcher); *id.*, at 3232 (remarks of Sen. Norbeck); S. Rep. No. 47, 73d Cong. 1st Sess., 1 (1933). As Representative Chapman stated, "[t]his legislation is designed to protect not only the investing public but at the same time to protect honest corporate business." 77 Cong. Rec. 2935 (1933). Respondent's assertion that Con-

The "sale of business" doctrine seeks to *restrict* that understanding of the scope of the federal securities laws. Rejection of the doctrine would, therefore, maintain the coverage of the Acts at their status prior to the doctrine's appearance.

ARC also devotes a substantial portion of its brief to the argument that permitting access to the protections of the securities laws would promote the breach of contractual obligations, including the "oppressive and unfair tactic" of "renouncing an express agreement to arbitrate." ARC Brief at 25. There is no agreement to arbitrate applicable here. *Jt.A.* 206-20. To the extent that any unfairness is worked by the holding in *Wilko v. Swan*, 346 U.S. 427 (1953), that the federal securities laws override an agreement to arbitrate, that "unfairness" exists in any case in which an agreement to arbitrate conflicts with the assertion of a claim under the securities laws. Moreover, only last week this Court ameliorated the "unfairness" of which ARC complains by holding that an agreement to arbitrate state law claims may be enforced even where those claims are pendent to a federal securities claim. *Dean Witter Reynolds, Inc. v. Byrd*, 53 U.S.L.W. 4222 (March 5, 1985).



gress' concern was limited to investors is thus manifestly inconsistent with the legislative history.

441 U.S. 768, 776 (1979).

In none of this Court's previous decisions is there any hint that it believed Congress intended to restrict the protections of the securities laws to "passive investors." Cf. Respondents' Brief at 12-15. To the contrary, the Court has unhesitatingly, and without dissent, applied the securities laws to transactions in which parties who were by no means "passive investors" were defrauded in connection with the purchase or sale of securities. *E.g.*, *Rubin v. United States*, 449 U.S. 424 (1981) (individually negotiated pledge of securities to bank); *United States v. Naftalin*, 441 U.S. 768 (1979) (fraud on brokers); *Superintendent of Insurance v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971) (fraudulent activities in connection with private transaction).

### III. THE "SALE OF BUSINESS" DOCTRINE FINDS NO SUPPORT IN THE LOWER COURTS' APPLICATION OF THE INVESTMENT CONTRACT TEST TO GENERAL PARTNERSHIP INTERESTS.

*Amicus* ARC argues that the Ninth Circuit's decision finds "compelling support" in the analysis employed by some lower courts when considering whether a general partnership interest is a "security." According to ARC, the lower courts' application of the investment contract test to general partnership interests indicates that the test should be applied to a purchase of stock carrying with it some post-sale ability to influence the affairs of the corporation. To do otherwise, it asserts, "would create a serious anomaly under the federal securities laws and would blink at economic reality." ARC Brief at 18-19.

But the investment contract test has been applied to general partnership interests only because "general partnership interests" are not among the specific instruments listed in the definitional sections of the 1933 or 1934 Acts. Accordingly, if they are to qualify as "securities" they

must necessarily achieve coverage by meeting the test developed for the more variable form of "investment contract." Subjecting general partnership interests to the test applicable to the only category of securities into which they can fit—investment contracts—is hardly remarkable, nor does it provide support (compelling or otherwise) for applying the investment contract test to the separately enumerated instrument of stock. Indeed, the very complexity of the factual analysis employed by lower courts to determine whether a specific partnership interest in the hands of a specific partner is an "investment contract" compels the conclusion that the application of the securities laws to traditional common "stock" should not be permitted to depend upon such lengthy threshold inquiries. See *Williamson v. Tucker*, 645 F.2d 404, 417-26 (5th Cir. 1981) (considering whether partner could "exercise meaningful partnership powers," or whether partner is "so inexperienced" that he is "incapable of intelligently exercising his partnership . . . powers," or whether partner is dependent upon managerial ability of promoter or manager).

Moreover, no "anomaly" would be created by treating the acquisition of a general partnership interest differently from the acquisition of stock. In practically every area in which the law touches general partnerships and corporate entities, it treats them differently. A partner has unlimited personal liability for obligations of the partnership. The liability of a corporate shareholder is limited to his investment in his stock. A partner who sells his partnership interest remains liable on obligations accruing before the transfer, the seller of stock does not. See Uniform Partnership Act §§ 15, 29, 36. The general partner and the corporate shareholder also receive widely divergent treatment with respect to taxation, transferability of their interests, powers to manage the business, duties to co-owners and their ability to sue or be sued. Treating them differently under the securities laws does no more than recognize that they are distinct types of legal entities.



#### IV. THE SECURITIES AND EXCHANGE COMMISSION'S VIEWS ARE ENTITLED TO SUBSTANTIAL WEIGHT.

The views of an agency interpreting a statute under which it operates are entitled to "considerable weight." *United States v. National Association of Securities Dealers*, 422 U.S. 394, 719 (1975). See also *Saxbe v. Bustos*, 419 U.S. 65, 74 (1974); *Investment Company Institute v. Camp*, 401 U.S. 617, 626-27 (1971); *Udall v. Tallman*, 380 U.S. 1, 16 (1965). The Securities and Exchange Commission, in its *amicus* brief, has urged reversal of the decision below, asserting that persons who "purchase what is unquestionably stock should have the protection that investors reasonably expect to be associated with stock," that the "adoption of the analysis underlying the sale of business doctrine could adversely affect protection for those who purchase instruments other than stock, such as notes and debt instruments," and that "enforcement actions brought by the Commission" could be impaired. SEC *Amicus* Brief at 2-3.

*Amicus* ARC, itself a seller of stock seeking to avoid liability in another case, and respondents both seek to denigrate the views expressed by the Securities and Exchange Commission as an *amicus* supporting petitioner. ARC suggests that the arguments presented in the *amicus curiae* brief of the United States<sup>5</sup> in *Marine Bank v. Weaver*, 455 U.S. 551 (1982), conflict with arguments now made by the SEC in support of petitioner. ARC Brief at 26 n.6. ARC seeks to support this suggestion by taking quotations from the *Marine Bank* brief out of context and presenting them in a manner that seriously distorts the government's position in *Marine Bank*.

<sup>5</sup> ARC mischaracterizes the *amicus* brief of the United States in *Marine Bank*, 455 U.S. 551 (1982), as the SEC's. But that brief was submitted on behalf of the United States and represented the composite views of the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency as well as those of the SEC.

Quoting from the *Marine Bank* brief, ARC contends, for example, that:

The SEC acknowledged that it is necessary to look beyond the definitional language [of the statutes] "in those cases in which there is evidence that transactions of the type at issue were not intended to come within the scope of the statute."

ARC Brief at 26 n.6. ARC's quotation, however, omits the first part of the sentence, thereby effectively reversing its sense. The sentence in its entirety reads:

The need to look beyond the statutory definitional language arises *only* in those cases in which there is evidence that transactions of the type at issue were not intended to come within the scope of the statute.

Brief for the United States as *Amicus Curiae* at 10 n.11 in *Marine Bank v. Weaver*, 455 U.S. 551 (1982) (hereinafter *Marine Bank* Brief) (emphasis supplied).

In fact the thrust of the government's argument in *Marine Bank* was almost directly the opposite of what is attributed to it by ARC. The passage from which ARC severed the above quotation asserts (as the SEC continues to assert here) that, as to those conventional financial instruments explicitly listed in the statutory definition (such as stock), the plain language of the statute should apply:

We do not suggest that in all cases federal courts need sift the circumstances surrounding a transaction to form an ad hoc opinion on whether the transaction is subject to the federal securities laws. *The comprehensive and carefully prescribed definitions in the securities laws ordinarily apply at face value, and generally are themselves a safe guide to congressional intent.*

*Marine Bank* Brief at 10 n.11 (emphasis supplied).

ARC further distorts the government's position in *Marine Bank* by failing to mention that a separate contemporaneously passed regulatory scheme existed for the

bank certificates of deposit involved there. The dominant theme of the government's brief was that, "The protection afforded by this comprehensive scheme of regulation substantially eliminates the need for application of the antifraud provisions of the securities laws." *Marine Bank* Brief at 6. The government argued, as ARC points out, that it was "Congress' intent to avoid regulating those 'types of securities and securities transactions where there is no practical need for [the statute's] application or where the public benefits are too remote.'" ARC Brief at 26 n.6. But the government based its conclusion as to Congress' intent to avoid redundant federal regulation on the fact that the banking industry "already is subject to pervasive regulation to protect depositors," that to apply the securities laws to certificates of deposit would be "redundant" and that the legislative history of the Acts contained expressions that depositors in insured banks did not need the protection of the securities laws. *Marine Bank* Brief at 24.

Perhaps the most serious distortion of the government's *Marine Bank* brief is accomplished by ARC's substitution of "parties to commercial contracts" for "depositors" in the following adulterated "quotation" attributed to the *Marine Bank* brief:

It was the interest of investors [as opposed to parties to commercial contracts] that required special protection under the securities laws.

ARC Brief at 26 n.6, quoting *Marine Bank* Brief at 18. The passage, as originally written, in no way relates to "parties to commercial contracts." Instead, the undistorted version of the quoted passage appeared in a discussion of the legislative history bearing on the treatment under the securities laws of "deposit instruments issued by commercial banks." *Marine Bank* Brief at 17. The dichotomy drawn in that discussion was not between investors and "parties to commercial contracts," but between investors and "depositors." The original passage actually reads:

[T]here is evidence that, in considering the bill that became the Securities Exchange Act, Congress viewed the economic interests of *depositors* as being distinct from those of investors. It was the interest of investors that required special protection under the securities laws.

*Id.* at 18 (emphasis supplied).

Moreover, the government's *Marine Bank* brief did not, as ARC states, suggest there was a congressional "recognition that *persons in the position of the plaintiff*, on the one hand, and 'investors,' on the other, were properly 'viewed as standing in fundamentally different positions.'" ARC Brief at 26 n.6 (emphasis supplied). The passage selectively excerpted by ARC actually concludes, instead, that "investors and *depositors* were viewed as standing in fundamentally different positions." *Marine Bank* Brief at 18 (emphasis supplied).

The SEC has not, as ARC claims (ARC Brief at 26 n.6), abandoned the positions taken by the government in *Marine Bank*. ARC's distortion of those positions is both erroneous and—since an *amicus curiae* cannot file a reply brief to defend itself—unfair.

The respondents' brief echoes some of the distortions undertaken by ARC, suggesting that the SEC "recognized that the Acts were designed to help investors, not entrepreneurs such as the plaintiff in *Marine Bank*." Respondents' Brief at 36 n.28. Of course, the brief of the United States made no such recognition since it failed even to use the word "entrepreneur" and discussed only the distinction between depositors and investors. Accordingly, there is no reason for this Court to fail to accord to the Commission the deference to which the Court has long held an agency charged with administering a statute is entitled. See *United States v. National Association of Securities Dealers*, 422 U.S. 694, 719 (1975); *Saxbe v. Bustos*, 419 U.S. 65, 74 (1974).

**CONCLUSION**

For the reasons discussed above, and in our opening brief, the judgment of the Court of Appeals must be reversed, and the "sale of business doctrine" rejected.

Respectfully submitted,

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